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No. 87-

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

LOMBARDFIN S.p.A. and PAOLO MARIO LEATI,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Questions Presented

1. Whether constructive notice by publication to unnamed "certain purchasers" may be a constitutionally adequate basis for the assertion of *in personam* jurisdiction over nonresident aliens in a foreign country whose names and addresses were known to the plaintiff at the time of publication?

2. Whether constructive notice by publication permits a federal court to assert *in personam* jurisdiction over nonresident aliens in a foreign country in an action under the Securities Exchange Act of 1934 where such service is not authorized or permissible under Section 27 of that Act, 15 U.S.C. § 78aa (1982), Rule 4 of the Federal Rules of Civil Procedure, or the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638?

3. Whether mere awareness or actual notice of defendants that a lawsuit exists is a constitutionally permissible substitute for service of process although the defendants were not named or described in the caption as defendants?

4. Whether trading in shares of a target company on the basis of information received from another with no relation of trust or confidence to the target company who allegedly "misappropriated" the information from the acquiring company may be the basis of liability under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987)?

5. Whether the Securities and Exchange Commission is entitled to disgorgement although Section 21 of the Securities Exchange Act of 1934, 15 U.S.C. § 78u (1982 & Supp. IV 1986), does not confer such a right and although disgorgement has been held by this Court to be only for restitution, and, thus, not available where, as here, there was no showing that any damaged investors had sued, or even could sue, for restitution?

Parties

The parties to the proceeding below were the petitioners Paolo Mario Leati and Lombardfin S.p.A., the respondent Securities and Exchange Commission and the following appellants below: Trasatlantic Financial Co., S.A., Nayarit Investments, S.A., and Finvest Underwriters and Dealers Corp. The appeal of defendant Giuseppe B. Tome was dismissed by the court below.

Petitioner Lombardfin S.p.A. has no parent company, subsidiaries (other than wholly owned subsidiaries) or affiliates to list pursuant to Rule 28.1 of the Supreme Court Rules.

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SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, Lombardfin S.p.A. and Paolo Mario Leati, respectfully request that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered on November 20, 1987.

Opinions Below

The opinion of the Court of Appeals is reported as *SEC* v. *Tome*, 833 F.2d 1086 (2d Cir. 1987), and is reprinted in the

Appendix to this petition, *infra*, at A1-A24.[1] The decision of the United States District Court for the Southern District of New York is reported as *SEC* v. *Tome*, 638 F. Supp. 596 (S.D.N.Y. 1986), and is reprinted in the Appendix to this petition, *infra*, at A25-A82. Other reported opinions in this matter are *SEC* v. *Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981) (ordering disclosure of customers' identities), *SEC* v. *Tome*, 638 F. Supp. 629 (S.D.N.Y. 1986) (evidentiary rulings) and *SEC* v. *Tome*, 638 F. Supp. 638 (S.D.N.Y. 1986) (memorandum accompanying judgment re prejudgment interest), the latter two of which are reprinted in the Appendix to this petition, *infra*, at A83-A96 and A97-100, respectively.

Jurisdiction

The decision of the Court of Appeals was entered on November 20, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1982).

Statutes, Rules and Treaty Involved

The pertinent provisions of the following statutes, rules and treaty involved are reproduced in the Appendix to this petition, *infra*:

> Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638, Arts. 1, 15.
>
> Securities Exchange Act of 1934
>
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> § 21(e), 15 U.S.C. § 78u(e) (1982)
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> § 27, 15 U.S.C. § 78aa (1982)

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[1] Citations to the Appendix to this petition are denoted as "A ". References to "JA " and "JE " are to the joint appendix and the trial exhibits, respectively, submitted to the Court of Appeals.

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987)

SEC Rule 14e-3, 17 C.F.R. § 240.14e-3 (1987)

Fed. R. Civ. P. 4(c)(2)(C)(i)

Fed. R. Civ. P. 4(e)

Fed. R. Civ. P. 4(i)(1)

N.Y. Civ. Prac. L. & R. § 308 (McKinney 1972 & Supp. 1988)

N.Y. Civ. Prac. L. & R. § 314 (McKinney 1972)

N.Y. Civ. Prac. L. & R. § 315 (McKinney 1972)

Statement of the Case

Petitioner Lombardfin S.p.A. ("Lombardfin") is an Italian company doing business as a stock broker in Milan, Italy and Dr. Paolo Mario Leati ("Leati") is an Italian resident and citizen and an officer of Lombardfin. Lombardfin is a broker-dealer registered as such with the Securities and Exchange Commission ("SEC").

Leati and Lombardfin were never served with a summons or complaint in this action and were not even named as defendants until the day of trial. Neither appeared in the action. Nevertheless, a judgment *in personam* was entered against them, following a one-day trial, as to them held *in absentia*. The judgment held them liable for trading on what the district court found was misappropriated material nonpublic information in violation of Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78n(e) (1982), and Rules 10-b(5) and 14-e(3) promulgated thereunder, 17 C.F.R. §§ 240.10b-5, 240.14e-3 (1987).

The judgment permanently enjoined Leati and Lombardfin from future conduct in violation of the antifraud provisions of the federal securities laws and ordered them to disgorge $1,345,925 in alleged profits, plus interest thereon in the amount of $649,473.32, from the purchase and sale in March 1981 of securities of the St. Joe Minerals Corporation.

Respondent SEC commenced this action in 1981 against unnamed "certain purchasers" of securities of the St. Joe Minerals Corporation ("St. Joe") and two named banks. It subsequently amended the complaint to add as named defendants Giuseppe Tome and three Panamanian corporations affiliated with Tome. The SEC's central allegation was that Tome misappropriated and traded on material nonpublic information from Joseph E. Seagram & Sons, Inc. concerning its intention to make a tender offer for St. Joe securities in March 1981. The second amended complaint, dated May 13, 1982, further alleged that the Tome companies and unnamed "certain purchasers" acting through various European financial institutions, which included Lombardfin, also purchased St. Joe securities in March 1981, allegedly because of information supplied by Tome (JA-185, 192). It did not name Leati or Lombardfin as a defendant.

In May of 1982 the district court allowed the SEC to publish a notice in the *International Herald Tribune* stating that the unidentified persons who purchased St. Joe securities in March 1981 through the listed financial institutions, which included Lombardfin, were defendants in the action. The notice did not contain the allegations of the complaint other than to describe the action as one alleging violations of the securities law provisions which "prohibit the use of material non-public information in connection with securities transactions." The published notice is reproduced in the Appendix to this petition, *infra*, at A106, and reprinted therein, *infra*, at A108.

At the time of publication the SEC was well aware of Lombardfin and Leati and had already been in communication with them concerning information the SEC had developed indicating the purchases of St. Joe securities through Lombardfin and the fact that these purchases had occurred after Tome had placed a telephone call to Lombardfin in Milan, Italy (JA-185, 192, 558-59; JE-471). The SEC knew the addresses of Leati and Lombardfin and clearly could have served Lombardfin and Leati with process personally in Milan, Italy either by any method permissible under the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638, or by

personal delivery pursuant to provisions of the Federal Rules of Civil Procedure. It did not do so. Indeed, at no time was personal service, or even service by mail, of a summons or a complaint ever attempted on Lombardfin or Leati. For the next three years, pretrial proceedings continued with respect to the SEC's claims against Tome and the Tome companies. At one stage, the SEC moved to have default judgments entered against all unnamed purchasers, citing as effective service the *International Herald Tribune* publication (JA-243). Such motion was not granted, and, petitioners submit, properly so.

On October 2 and 3, 1985, just a few weeks before the trial against Tome and the Panamanian companies was to commence, Leati and other officers of Lombardfin testified as third-party witnesses (JA-329-30; *see also* JA-356) at depositions taken by the SEC in Milan, Italy pursuant to a Letter Rogatory (JA-352). Two weeks later the SEC, on the eve of trial, sought to add Lombardfin and Leati as named party defendants, again pointing to the 1982 newspaper publication of notice to unnamed "certain purchasers" as constituting prior effective service of process upon them (JA-564-65, 586). On this occasion, the district court issued an order to show cause why Leati and Lombardfin should not be named as party defendants, returnable the day the trial was to commence (JA-591). While a copy of the order to show cause was delivered to Leati and Lombardfin in Italy, no summons or complaint was served upon them, with those papers (JA-778) or otherwise.

On October 25, the day of trial and return date of the above motion, the district court first inquired whether Leati and Lombardfin were appearing in opposition to the motion and, hearing no opposition, granted "by default" the SEC's motion to change the summons and complaint so as to add the names of Leati and Lombardfin as defendants (JA-600). No notice was ever given to Leati and Lombardfin that the motion was granted, no summons or complaint was served upon them thereafter, and they were given no opportunity to respond to the complaint.

Immediately after granting the motion, the district court commenced the trial of the action (JA-601), which was defended by

the only parties appearing in the case, Tome and the Panamanian companies and one of the two originally named banks. By midafternoon on the same day, the trial concluded, the SEC having offered no live testimony but only deposition testimony and various exhibits. In particular, the SEC offered and the court received the depositions of Edgar Bronfman, Seagram's Chief Executive Officer, and Dionisio Csopey, a disgruntled former Lombardfin employee, who came to the United States in September 1985 and voluntarily testified for the SEC against Leati and Lombardfin (JE-385, 430-32). Both depositions were taken without notice to or attendance by Leati or Lombardfin or their counsel, and without the opportunity to cross-examine the witnesses, and the Bronfman deposition was taken in 1981, long before even the publication in the *International Herald Tribune*.

On June 3, 1986 the district court issued its findings and opinion in which it concluded that Leati and Lombardfin were liable for trading, as *brokers* for purchases by others (A74), on misappropriated material nonpublic information disclosed by Tome in breach of his fiduciary or similar duty to Seagram, its shareholders and Bronfman (A73).

The district court did not make any findings of fact regarding the issue of whether it had personal jurisdiction over Leati and Lombardfin. Rather, the court merely noted, *without* any discussion of the serious constitutional issues involved, and *without* any citation of case authority, that Lombardfin and Leati were "aware" of the suit (A73).

Petitioners appealed from the judgment to the United States Court of Appeals for the Second Circuit on the following grounds: (1) the district court lacked personal jurisdiction over them; (2) defendants were never afforded an opportunity to answer the complaint, to conduct pretrial discovery or to prepare for and participate in the trial, and they were thereby denied due process of law; (3) contrary to Rule 32(a) of the Federal Rules of Civil Procedure, deposition transcripts were admitted into evidence against Leati and Lombardfin even though these defendants were neither given notice of the depositions nor afforded an opportunity to cross-examine the deponents; (4) the evidence

submitted at trial was insufficient to establish either (a) that Leati and Lombardfin had traded in St. Joe securities on the basis of misappropriated material nonpublic information or (b) that these defendants had the requisite intent to violate the federal securities laws, and consequently the judgment entered against them was clearly erroneous; (5) the evidence submitted at trial was insufficient to support an injunction against Leati and Lombardfin; and (6) the district court's order of disgorgement was improper, unwarranted and constituted an abuse of discretion.

The Second Circuit affirmed on all points. It held that the constitutional bar to service by publication if, as was admittedly the case here, the defendant's name and address are reasonably ascertainable, *Mennonite Board of Missions* v. *Adams*, 462 U.S. 791 (1983); *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), did not apply in this case. It held, first, that Leati and Lombardfin were "unknown" defendants at the time of publication (A19) because the SEC allegedly did not know that Leati and Lombardfin were among the allegedly guilty purchasers of St. Joe securities (A19)[2] and that constructive notice by publication of a summons addressed to unnamed "certain purchasers" was a sufficient basis for the district court's assertion of *in personam* jurisdiction over them "in light of the fact that members of the securities industry like Leati and Lombardfin may be expected to be aware of a publicly announced SEC investigation involving insider trading during a high-visibility takeover" (A17).

Alternatively, noting that this was not a case concerning the adequacy of constructive notice (A17), the Second Circuit held that Leati and Lombardfin were in any event actually "cognizant

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[2] In fact the district court had premised its finding of liability as to Leati and Lombardfin on their status as brokers (A74), and not purchasers, a status of which the SEC was aware at the time of the publication, as a review of the contemporaneous second amended complaint confirms (JA-185). Of course, the *International Herald Tribune* publication (A106) did not even refer to those who acted as brokers as being among the intended defendants.

of the action years before the SEC discovered evidence of their involvement" (A18).[3]

The Second Circuit further affirmed the district court's finding of liability against Leati and Lombardfin solely on the basis of hearsay statements not subject to cross-examination by them, and affirmed the district court's order of permanent injunction and disgorgement.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION BELOW CONFLICTS WITH APPLICABLE DECISIONS OF THIS COURT AND OTHER COURTS OF APPEALS THAT NOTICE BY PUBLICATION TO UNIDENTIFIED PERSONS WHOSE NAMES AND ADDRESSES ARE KNOWN IS CONSTITUTIONALLY IMPERMISSIBLE TO ESTABLISH *IN PERSONAM* JURISDICTION

The Second Circuit in a headlong attempt to close another chapter in an alleged insider trading scandal has approved constructive notice by publication in an *in personam* action to unidentified persons whose names and addresses were known to the plaintiff, never before countenanced by this Court.

This decision establishes new law contrary to the most fundamental precepts of constitutional prerequisites to the assertion

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[3] As evidence of this "cognizance", the court referred to various deposition statements of Dionisio Csopey, which the court held admissible against Lombardfin and Leati only because of its conclusion, based upon this same deposition, that Leati and Lombardfin had actual notice before that deposition was noticed that they were among those the SEC intended to be defendants (A21). Thus, in a totally circular, or bootstrap fashion, the court found "actual notice" by reason of the contents of a hearsay transcript which was found admissible only because of the finding of "actual notice".

of personal jurisdiction and contrary to basic notions of fair play and substantial justice. Until this case, notice by publication was never permissible to establish *in personam* jurisdiction over nonresident nondomiciliaries. Instead, personal service or at the least service by mail of a summons and complaint was always the bare minimum constitutionally required to establish *in personam* jurisdiction, and this was true whether or not the intended defendant was aware of the suit or aware that the plaintiff wanted to sue him. Rule 4 of the Federal Rules of Civil Procedure, in dealing with service on aliens outside the United States, requires that a summons and complaint be served on the defendant, not simply a notice, with no complaint, published in a newspaper not even in their home country.

If not reversed, this decision gives the SEC, and indeed any plaintiff, the unfettered power to obtain, *ex parte*, judgments establishing the personal liability of persons whose identities are not revealed until it is too late for them to answer to and defend the charges against them, by the simple expedient of commencing the action against unidentified persons and effecting service by publication of a notice in a newspaper and thereafter claiming the defendant was, or should have been, aware of the suit. The certainty of service of process as a means of commencing litigation either through personal service, or at the least the mailing, of a summons and complaint is completely removed. Under the precedent of this case it is clear that the SEC, or any party, could sue "John Does", claiming not to know the identity of the defendants or claiming not to know that they should be defendants, and then amend the caption to insert their names as late as the day of trial. If the defendants to be bound *in personam* are not afforded certainty of personal service, or at least service by mail, of a summons and complaint and the opportunity to respond to a complaint and to present their defense, as Leati and Lombardfin were not, there is nothing to prevent the process of the courts from being "the constant instruments of fraud and oppression." *Pennoyer* v. *Neff*, 95 U.S. 714, 726 (1878).

Until this decision, it has been an indisputable principle of American law, upheld by this Court time and time again, that

service by publication on nonresident defendants[4] does not confer *in personam* jurisdiction,[5] and any *in personam* judgment entered against such a defendant so served who has not appeared is void.[6] As this Court stated long ago:

> "If, without personal service, judgments *in personam*, obtained *ex parte* against non-residents and absent parties, upon mere publication of process, which, in the great majority of cases, would never be seen by the parties interested, could be upheld and enforced, they would be the constant instruments of fraud and oppression. . . .

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[4] Service by publication on an absent *domiciliary* who cannot with diligence be served in any other way may be constitutionality sufficient in an *in personam* action under the authority of *Milliken* v. *Meyer*, 311 U.S. 457 (1940) (amenability to suit as an incident of domicile is not affected by absence from the state). *E.g.*, *Butler* v. *McKey*, 138 F.2d 373 (9th Cir. 1943), *cert. denied*, 321 U.S. 780 (1944). The petitioners here, of course, are not domiciliaries.

[5] Cases in which publication has been allowed following attachment of the defendant's property in *quasi in rem* actions to support judgments *in personam*, such as *Fishman* v. *Sanders*, 15 N.Y.2d 298, 206 N.E.2d 326 (1965), are limited to that jurisdiction, assuming they even survive *Shaffer* v. *Heitner*, 433 U.S. 186 (1977).

[6] *McDonald* v. *Mabee*, 243 U.S. 90, 92 (1917) ("There is no dispute that service by publication does not warrant a personal judgment against a non-resident."); *Hart* v. *Sansom*, 110 U.S. 151, 155 (1884) (*in personam* decree is supportable against nonresident nondomiciliary only with actual service, "and constructive service by publication in a newspaper is not sufficient"); *Clark* v. *Wells*, 203 U.S. 164 (1906) (*in personam* judgment against nonresident without personal service in state modified to judgment *in rem* since only service within state was by publication); *Haddock* v. *Haddock*, 201 U.S. 562, 567 (1906) ("Where a personal judgment has been rendered in the courts of a State against a non-resident merely upon constructive service and, therefore, without acquiring jurisdiction over the person of the defendant, such judgment . . . is by operation of the due process clause of the Fourteenth Amendment void as against the non-resident . . . ."); *Freeman* v. *Alderson*, 119 U.S. 185, 190 (1886) (service by publication "could not authorize the creation of any personal demand against the [nonresident] defendant"); *Pennoyer* v. *Neff*, 95 U.S. 714 (1878).

> "[Substituted service by publication] may answer in all actions which are substantially proceedings *in rem*. But where the entire object of the action is to determine the personal rights and obligations of the defendants, that is, where the suit is merely *in personam*, constructive service in this form upon a non-resident is ineffectual for any purpose."

Pennoyer v. *Neff*, 95 U.S. at 726-27.

In *Mennonite Board of Missions* v. *Adams*, 462 U.S. 791 (1983), this Court took occasion to note that personal service or at least service by mail has always been considered necessary in *in personam* actions and that "[c]onstructive notice was never deemed sufficient to bind an individual in an action *in personam*." *Id.* at 796 n.3. Constructive notice has always been restricted to proceedings *in rem* or *quasi in rem*. While the traditional distinctions between due process requirements for service in actions *in rem* and *in personam* no longer obtain, the *Mennonite* Court explained,

> "the Court has not left all interested claimants to the vagaries of indirect notice. Our cases have required the State to make efforts to provide actual notice to all interested parties comparable to the efforts that were previously required only in *in personam* actions."

Id. Rather than raise the standard for *in rem* actions to that required for *in personam* actions, as the above statement from *Mennonite* would require, the Second Circuit has lowered the service requirements in this, an *in personam* action, even below those found constitutionally necessary in *Mennonite* for *in rem* jurisdiction.

The Second Circuit's ruling upholding the constitutionality of this purported service is directly contrary to the rulings of this Court in *Mennonite* and *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), which squarely held that service by publication is constitutionally insufficient, as a violation of due process, to confer jurisdiction over a defendant whose name

and address are reasonably ascertainable. *Mennonite*, 462 U.S. at 800; *Mullane*, 339 U.S. at 320.[7]

While the Second Circuit argues that *Mennonite* and *Mullane* were inapplicable because at the time of publication the SEC did not know of Lombardfin's and Leati's alleged involvement in "Tome's scheme" (A19) and thus should be treated as if the SEC could not reasonably ascertain their names and addresses, one cannot avoid the fact that at the time of publication the SEC knew their names and addresses, knew that there had been telephone calls between Tome and Lombardfin at the time of the subject purchases,[8] and in fact the SEC had already been in actual communication with representatives of Lombardfin in order to obtain additional information (JA-185, 192, 558-59; JE-471).

Even if Leati and Lombardfin were so considered "unknown defendants," the Second Circuit's ruling is in conflict with the decisions of other Courts of Appeals which have dealt with publication to unknown persons, which have held that an unnamed non-appearing defendant who has not been served in accordance with due process cannot be bound by any resulting judgment. *Nagle* v. *Lee*, 807 F.2d 435, 440 (5th Cir. 1987) ("[T]he mere naming of a person through use of a fictitious name does not make that person a party absent voluntary appearance or proper service of process."). In *Keno* v. *Doe*, 74 F.R.D. 587 (D.N.J. 1977), *aff'd without opinion*, 578 F.2d 1374 (3d Cir. 1978), the court noted, "[B]y naming 'John Doe' as defendant, there is no

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[7] *See also Schroeder* v. *City of New York*, 371 U.S. 208, 212-13 (1962) ("notice by publication is not enough with respect to a person whose name and address are known or very easily ascertainable"); *Walker* v. *City of Hutchinson*, 352 U.S. 112 (1956).

[8] At the time of publication the SEC actually knew that Lombardfin had received calls from Tome on March 10, 1981 and that Lombardfin had effected the trades in St. Joe securities for various of its accounts on the same day, as alleged in the contemporaneous complaint (JA-192). In fact the SEC then knew every fact that is alleged in the final complaint in this action, since the complaint on which Leati and Lombardfin were held liable is virtually identical to that in effect at the time of the publication. (*Compare* JA-182-199 *with* JA-753-777.)

specific person to be served with process and called upon to answer and defend. This fact would rob any proceeding on Keno's complaint of any semblance of due process, and would convert it into an *ex parte* action." *Id.* at 588.

Exhaustive research has uncovered no case in the annals of U.S. jurisprudence, until this one, which permitted the entry of a judgment of personal liability based upon service by publication to unidentified persons.

As a consequence of this decision, Lombardfin and Leati, both foreign citizens not residing in the United States, have been subjected to a final judgment of personal liability without ever having had any opportunity to defend and have their constitutionally guaranteed day in court. Whatever the outcome might be of any subsequent action in which they are properly served with a summons and complaint, they should be entitled to their day in court before they can be bound by any judgment of personal liability.

II.

THE DECISION BELOW PERMITS FEDERAL COURTS TO ASSERT PERSONAL JURISDICTION OVER NONRESIDENT ALIENS WITHOUT AUTHORIZATION BY STATUTE OR RULE AND CONTRARY TO APPLICABLE TREATY PROVISIONS

The district courts' power to exercise personal jurisdiction is limited by federal statute and rule as well as by due process requirements. In *Omni Capital International* v. *Rudolf Wolff & Co.*, 108 S. Ct. 404 (1987), this Court addressed the question of extra-constitutional limits imposed on the exercise of personal jurisdiction by the district courts in the context of amenability to service of summons in a private action under the Commodity Exchange Act. There the Court held that there must be authorization by statute or rule establishing the defendant's amenability to service before the court has the power to exercise its personal jurisdiction over the defendant by service of its process. The *Omni* Court stated:

> "Before a federal court may exercise personal jurisdiction over a defendant, the procedural requirement of service of summons must be satisfied. '[S]ervice of summons is the procedure by which a court having venue and jurisdiction of the subject matter of the suit asserts jurisdiction over the person of the party served.' *Mississippi Publishing Corp.* v. *Murphree*, 326 U.S. 438, 444-445 . . . (1946). Thus, before a court may exercise personal jurisdiction over a defendant, there must be more than notice to the defendant and a constitutionally sufficient relationship between the defendant and the forum. There also must be a basis for the defendant's amenability to service of summons. Absent consent, this means there must be authorization for service of summons on the defendant."

Id. at 409 (citation omitted).

The same limitation on the district court's power to exercise its personal jurisdiction must obtain with respect to the manner in which its process is served. If a federal court is not authorized by statute or by rule to extend its process in a particular manner, then it must equally lack the power to assert its personal jurisdiction over a defendant by utilizing such manner. Certainly where, as here, a federal statute or rule limits the manner in which a federal court may extend its process, service in any manner inconsistent with such limitation cannot confer upon the court personal jurisdiction over the defendant.

A. *Notice By Newspaper Publication Is Not Permitted Under Section 27 Of The Securities Exchange Act Of 1934.*

In this enforcement action under the Securities Exchange Act of 1934 (the "Exchange Act"), the court's powers with respect to service of process are in the first instance governed by Section 27 of the Exchange Act, 15 U.S.C. § 78aa (1982). Section 27, which provides for nationwide service of process, explicitly dictates where process may be served upon a defendant in an action under the Exchange Act and implicitly prescribes personal service on

the defendant. It provides that in any suit or action under the Exchange Act process may be served in any "district of which the defendant is an inhabitant or wherever the defendant may be found."[9]

Petitioners are unaware of any case in which the question has been addressed whether Section 27 requires personal service. Given the clear requirement for personal service, or at least service by mail, which has applied in *in personam* actions until this case, the lack of judicial pronouncement on this point is not remarkable. However, since this case will, if not reversed, serve as precedent for the permissibility of notice by publication in, at a minimum, any action under the Exchange Act, the question of the scope of this provision has taken on a new importance.

Petitioners submit that it is apparent from the language of the provision that it contemplates personal service or at least some method of service which in the ordinary course should reach the defendant where he is an inhabitant or is found since the propriety of the service depends upon the location of the defendant.

Certainly a statutory provision authorizing service wherever the defendant is found cannot be satisfied as to Leati and Lombardfin, who, as the SEC concededly knew, were Italian citizens at all times found in Milan, Italy, by a publication in an English-language newspaper published in Paris (JA-227-30).

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[9] Section 27 provides in relevant part:

> "Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, *and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.*"

15 U.S.C. § 78aa (1982) (emphasis added).

B. *The Newspaper Publication Was Impermissible Under Applicable Provisions Of Rule 4 Of The Federal Rules Of Civil Procedure.*

While the Second Circuit referred to the publication in the *International Herald Tribune* as a publication of the summons and complaint (A17, A18 n.6), a review of that publication (A106) confirms that *no complaint* was included in the publication.[10] The newspaper publication in this case was a publication of only a Summons with Notice.

As such, it failed to comply with the applicable provisions of Rule 4 of the Federal Rules of Civil Procedure dealing with service in foreign countries, which require service of both a summons and a complaint. Rule 4(i)(1)(E) does not permit service on a nonresident in a foreign country of only a summons without the complaint. It requires service, by one of the means specified therein, of a "summons and complaint."[11]

Further, Rule 4(i)(1)(E) implicitly requires personal service or at least service by mail both because it requires service of a complaint and because Rule 4(i)(1), by prescribing the qualifications of process servers for service permissible under subparagraph

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[10] Thus, the Second Circuit's finding that Leati and Lombardfin had actual notice of the charges against them (A18) was contrary to the facts established in the record.

[11] The Rule provides, in pertinent part, as follows:

> "When the federal or state law referred to in subdivision (e) of this rule authorizes service upon a party not an inhabitant of or found within the state in which the district court is held, and service is to be effected upon the party in a foreign country, it is also sufficient if *service of the summons and complaint* is made: ... (E) as directed by order of the court."

Fed. R. Civ. P. 4(i)(1) (emphasis added).

(E),[12] contemplates that service will be effected by qualified persons.

Rule 4(c)(2)(C)(i), which also requires service of a "summons and complaint", allows service in any manner pursuant to the law of the state where the district court is located.[13] Although service by publication is permissible in certain circumstances under New York law, it is not allowed in the situation presented here.[14]

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[12] That Rule provides as follows:

> "Service under (C) or (E) above may be made by any person who is not a party and is not less than 18 years of age or who is designated by order of the district court or by the foreign court. On request, the clerk shall deliver the summons to the plaintiff for transmission to the person or the foreign court or officer who will make the service."

Id.

[13] The Rule provides as follows:

> "A summons and complaint may be served upon a defendant of any class referred to in paragraph (1) or (3) of subdivision (d) of this rule [an individual and a domestic or foreign corporation, partnership or unincorporated association]—
>
> (i) pursuant to the law of the State in which the district court is held for the service of summons or other like process upon such defendant in an action brought in the courts of general jurisdiction of that State . . . ."

Fed. R. Civ. P. 4(c)(2)(C)(i).

[14] Section 315 of New York's Civil Practice Law and Rules ("CPLR") authorizes service by publication only in actions described in CPLR § 314, which are matrimonial, property title and attachment actions, *i.e.*, *in rem* or *quasi in rem* actions, and in those cases only "if service cannot be made by another prescribed method with due diligence." N.Y. Civ. Prac. L. & R. § 315 (McKinney 1972). As to natural persons, the CPLR authorizes service "in such manner as the court . . . directs, if service is impracticable under paragraphs [dealing with personal service and service by mail] of this section." N.Y. Civ. Prac. L. & R. § 308(5) (McKinney 1972 & Supp. 1988). While publication has been authorized under this provision upon natural persons, it has never been authorized to obtain *in personam* jurisdiction over parties said to be persons unknown. Indeed, the New York Court of Appeals has never approved such publication, even as to known persons, as the sole method of service in an *in personam* action. *See Dobkin* v. *Chapman*, 21 N.Y.2d 490, 236 N.E.2d 451 (1968).

Only Rule 4(e), dealing with extraterritorial service generally, contemplates the possibility of service of a summons without a complaint.[15] Under Rule 4(e), service by publication may be permitted when authorized by a federal statute or by a statute or rule of court of the state in which the district court is held. There is no federal statute authorizing service by publication in the circumstances of this case.[16] Nor is there any New York statute or rule of court so authorizing publication.[17]

Thus, the publication here was not authorized under Rule 4 of the Federal Rules of Civil Procedure.

C. *Notice By Newspaper Publication Should Not Be Permitted Where The Hague Convention On The Service Abroad Of Judicial And Extrajudicial Documents In Civil Or Commercial Matters Applies.*

In this case, service should have been effected in accordance with the Hague Convention on the Service Abroad of Judicial

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[15] Rule 4(e) provides in pertinent part:

> "Whenever a statute of the United States or an order of court thereunder provides for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state in which the district court is held, service may be made under the circumstances and in the manner prescribed by the statute or order, or, if there is no provision therein prescribing the manner of service, in a manner stated in this rule. Whenever a statute or rule of court of the state in which the district court is held provides (1) for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state, . . . service may . . . be made under the circumstances and in the manner prescribed in the statute or rule."

Fed. R. Civ. P. 4(e).

[16] Where Congress has seen fit to provide for service by publication, it has done so expressly. 8 U.S.C. § 1451(b) (1982); 28 U.S.C. § 1655 (1982); 35 U.S.C. § 146 (1982 & Supp. III 1985); 38 U.S.C. § 445 (1982). None of these statutes is applicable here.

[17] See note 14, *supra*.

and Extrajudicial Documents in Civil or Commercial Matters (the "Hague Service Convention"),[18] *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638, since Italy and the United States are both signatories thereto and Leati and Lombardfin are Italian citizens located in Italy.

Although this Court has not explicitly addressed the question, the Hague Service Convention on its face would appear to provide the exclusive means of service when the defendant to be served is a citizen of and resident in a signatory country. By its express terms, the Hague Service Convention provides that it "*shall apply in all cases*, in civil or commercial matters, where there is occasion to transmit a judicial or extrajudicial document for service abroad." *Id.* Art. 1 (emphasis added).

This Court has previously recognized that this language is mandatory. In *Societe Nationale Industrielle Aerospatiale v. United States District Court for the Southern District of Iowa*, 107 S. Ct. 2542 (1987), this Court refused to hold that the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, *opened for signature* Mar. 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, which, like the Hague Service Convention, was adopted by the Hague Conference on Private International Law, provided the exclusive procedures for obtaining documents and information located within the territory of a foreign signatory. In doing so, this Court relied in part on the lack of mandatory language in the convention, particularly since the same body had used mandatory language in the earlier service convention. The *Societe Nationale* Court stated,

> "The Hague Conference on Private International Law's omission of mandatory language in the preamble is

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[18] Under the Hague Service Convention, service of process on Leati and Lombardfin could have been made at any time through Italy's central authority (Art. 5); additionally, the Convention does not interfere with the freedom to send judicial documents directly by postal channels (Art. 10(a)), or the freedom of competent persons of the country of origin or any person interested in the judicial proceeding to effect service of process directly through competent persons of the country of destination (Art. 10(b), (c)), so long as the receiving country has not specifically objected to such methods of service, and Italy has not so objected; and the Convention does not affect the propriety of any other method of transmission permitted by the receiving country (Art. 19).

> particularly significant in light of the same body's use of mandatory language in the Preamble to the Hague Service Convention, 20 U.S.T. 361, T.I.A.S. No. 6638. . . . [T]he Service Convention was drafted before the Evidence Convention, and *its language provided a model exclusivity provision* that the drafters of the Evidence Convention could easily have followed had they been so inclined."

107 S. Ct. at 2550 n.15 (emphasis added).

Even if this Court should determine that the Hague Service Convention does not provide the exclusive means of service of federal process on a defendant who is a citizen of and resident in a signatory country, international comity would require that the courts of the United States give priority to the methods of service prescribed therein and deference to the interests of the foreign signatories, *Societe Nationale*, 107 S. Ct. at 2557-68 (dissenting opinion), at least wherever possible, *id.* at 2555-57 (majority opinion).

In this regard, it is significant to note that the newspaper publication in this case would not have been sufficient under the Hague Service Convention to support the resulting "default judgment." The Convention specifies that before a default judgment can be given, service of the "summons or equivalent document" must have been actually delivered to the defendant by a method provided for by the Convention or served by a method prescribed by the internal law of the country of destination, and that in either case the service or delivery must have been effected in sufficient time to enable the defendant to defend. 20 U.S.T. 361, T.I.A.S. No. 6638. Art. 15. The Convention does not provide for service by publication in a newspaper, and petitioners are not aware of any provision under Italian law that would permit such service in this instance.

It is particularly inappropriate for the federal courts to make new law, as the Second Circuit has done in this case, increasing their ability to assert personal jurisdiction over nonresident defendants where the defendants are aliens resident in a foreign

country. In such cases, the service procedures prescribed in the Hague Service Convention should control, or at least be given priority, and those procedures do not include notice by newspaper publication. Important issues of international policy, which are the domain of the executive branch of government, are implicated. One can only speculate as to the reaction of the Italian government, and indeed of any foreign sovereign, to the assertion by the courts of the United States of personal jurisdiction over its nationals by the method employed here, and as to the impact which the change in law wrought by the Second Circuit may have on international agreements providing for mutual recognition and enforcement of judgments. *See* Born, *Reflections on Judicial Jurisdiction in International Cases*, 17 Ga. J. Int'l & Comp. L. 1, 29 (1987).

III.

THE DECISION BELOW CONFLICTS WITH SETTLED LAW THAT "AWARENESS" OF THE FACT OF THE SUIT OR EVEN ACTUAL NOTICE OF THE SUIT DOES NOT EXCUSE PROPER SERVICE OF PROCESS

The Second Circuit's alternative holding that proper service was excused because there was actual notice is also contrary to rulings of this Court and of other Courts of Appeals that actual notice is legally and constitutionally irrelevant if the method of service employed is not constitutionally proper.

The Second Circuit's statement that personal service was not needed because "members of the securities industry like Leati and Lombardfin may be expected to be aware of a publicly announced SEC investigation involving insider trading during a high-visibility takeover" (A17), is directly contrary to this Court's ruling in *Mennonite*, *supra*, that proper service is required even though the intended recipients may be sophisticated enough to learn of the proceeding by other means. 462 U.S. at 799.

It has long been established that awareness of the existence of litigation, even awareness that one has been named as a

defendant in litigation, does not alter the requirement of valid service of process.[19] If the method of service employed is not constitutionally proper, actual notice has been held to be legally and constitutionally irrelevant. *See, e.g., Sieg* v. *Karnes*, 693 F.2d 803, 807 (8th Cir. 1982) (federal court has no jurisdiction to render a personal judgment over non-appearing defendant if service of process is not made in accordance with applicable federal or state statutory requirements, notwithstanding any actual notice); *SEC v. Gilbert*, 82 F.R.D. 723, 726 (S.D.N.Y. 1979).[20]

IV.

THIS COURT SHOULD DETERMINE WHETHER LIABILITY MAY BE IMPOSED UNDER SEC RULE 10b-5 FOR TRADING ON THE BASIS OF "MISAPPROPRIATED" INFORMATION IN THE ABSENCE OF A DUTY OF DISCLOSURE TO THE COMPANY WHOSE SECURITIES ARE TRADED

In *Carpenter* v. *United States*, 108 S. Ct. 316 (1987), this Court divided evenly on the question of the propriety of the

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[19] *Wuchter* v. *Pizzutti*, 276 U.S. 13, 24 (1928); *Orange Theatre Corp.* v. *Rayherstz Amusement Corp.*, 139 F.2d 871, 873 (3d Cir.), *cert. denied*, 322 U.S. 740 (1944) (where service is invalid, purported defendant is "entitled to ignore the whole proceeding and subsequently attack any default judgment which might result from it"); *Lichtenstein* v. *Jewelart, Inc.*, 95 F.R.D. 511, 513 (E.D.N.Y. 1982); *Ruddies* v. *Auburn Spark Plug Co.*, 261 F. Supp. 648, 657 (S.D.N.Y. 1966); *Kadet-Kruger & Co.* v. *Celanese Corp. of America*, 216 F. Supp. 249, 250 (N.D. Ill. 1963). *See also Raschel* v. *Rish*, 69 N.Y.2d 694, 504 N.E.2d 389 (1986); *Macchia* v. *Russo*, 67 N.Y.2d 592, 496 N.E.2d 680 (1986); *Abba Gana* v. *Abba Gana*, 251 Ga. 340, 304 S.E.2d 909 (1983) (actual notice of divorce proceeding by telephone call to spouse does not cure due process violation of service by publication authorized without constitutional prerequisite of showing of reasonable diligence to ascertain defendant's whereabouts).

[20] The Second Circuit's finding that there was actual notice was itself erroneous. It was based primarily on hearsay statements in Csopey's deposition transcript (A18), which the Second Circuit held admissible, despite the fact that no notice of the deposition was given to Leati and Lombardfin and thus they did not have the opportunity to cross-examine Csopey, on the ground that they were not entitled to notice due to failure to appear following what, based upon the Csopey transcript, the court found was their actual notice (A21). The

(footnote continued)

"misappropriation" theory of securities fraud as a basis of liability under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987), for trading on the basis of information obtained from someone other than an insider of the corporation whose securities were traded. This case presents the Court with the opportunity to resolve this question.

Leati and Lombardfin were held liable under Rule 10b-5 for buying St. Joe securities, as brokers, allegedly on the basis of information received from Tome,[21] which Tome allegedly misappropriated from Joseph E. Seagram & Sons, Inc. ("Seagram"),[22] that Seagram was about to announce its intention to make a tender offer for St. Joe stock. The district court found that Tome had a personal relationship with Seagram's Chief Executive Officer, Edgar Bronfman, and had a consultant relationship with Seagram (A34). He had no relationship with St. Joe, the corporation whose stock was traded. If Tome received any confidential or nonpublic information at all, it was received from Seagram, the acquiring company, and not from St. Joe, the target.

This Court has held that the mere possession of material inside or nonpublic information about a company does not give rise to a duty to refrain from trading in that company's stock prior to disclosure of such information. *Dirks v. SEC*, 463 U.S. 646, 654 (1983); *Chiarella v. United States*, 445 U.S. 222, 235 (1980). If Leati and Lombardfin can be subject to liability for

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Csopey transcript, admissible under the court's ruling only if there had been proper service, cannot itself be used to find such requisite proper service. Absent the Csopey transcript, there was no evidence to warrant a finding that personal service of process was not required.

[21] Leati, while readily admitting that he received a call from Tome recommending the purchase of St. Joe securities, categorically denied receiving any information from Tome about a Seagram tender offer (JA-472-73, 496). Leati directed the St. Joe purchase orders only after seeing the increased trading activity of the previous day, which he checked after talking to Tome (JA-477-78).

[22] Bronfman, Seagram's Chief Executive Officer, stated in his deposition testimony – the only available evidence on this point – that he *never* told Tome about Seagram's plans concerning the St. Joe tender offer (JE-128, 132-34, 156-58).

trading in these circumstances,[23] it can be only a derivative tippee liability based on the predicate that Tome had breached a duty not to disclose information which the securities laws may properly protect. *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 311 n.21 (1985); *Dirks*, 463 U.S. at 660; *SEC* v. *Switzer*, 590 F. Supp. 756 (W.D. Okla. 1984).

In *Chiarella*, this Court recognized the importance of the issue whether a person who has misappropriated material nonpublic information from an acquiring company should be held liable under Rule 10b-5 for trading on the basis of that information in securities of the target company in the absence of any relationship of trust or confidence to the target company, but the question was not presented in that case. Subsequently, the Second Circuit has held that Rule 10b-5 does proscribe such trading.[24] This Court squarely addressed the question in *Carpenter*, but it was not resolved or even discussed in that opinion due to the equal division of the Court.

It is a question of great importance to the securities industry and the bar, which this case allows this Court to resolve.

V.

THE DECISION BELOW ALLOWING DISGORGEMENT TO THE SEC IS CONTRARY TO STATUTE AND CONFLICTS WITH THE RULING OF THIS COURT THAT DISGORGEMENT IS RESTITUTIONARY

The SEC as a litigant is empowered to bring suit only by specific congressional mandate. The relief to which the SEC is

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[23] Even if Tome's mere suggestion to buy St. Joe securities could constitute material nonpublic information, the Lombardfin trades could not be in violation of Rule 10b-5 (or of Rule 14e-3) since Leati did not know that Tome had any duty of trust or confidence to, or indeed any relationship with, Seagram or Bronfman (JA-496) which Tome might be breaching. *See Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 311 n.21 (1985).

[24] *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). *See also SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *United States* v. *Reed*, 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985); *United States* v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986), *aff'd on other grounds*, 108 S. Ct. 316 (1987).

entitled must be found in the language of the statute itself, the "starting point in every case involving construction of a statute." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). *Accord Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 24 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976).

The SEC was not given the remedy of disgorgement by Congress. There is no provision in Section 21 of the Exchange Act, 15 U.S.C. § 78u (1982 & Supp. IV 1986), for disgorgement except for the penalty provision in Section 21(d)(2), 15 U.S.C. § 78u(d)(2) (Supp. IV 1986), enacted in 1984, which is not applicable in this case. Sections 21(d)(1) and 21(e) of the Exchange Act, 15 U.S.C. § 78u(d)(1) (Supp. IV 1986); *id.* § 78u(e) (1982), give the SEC access to the district court only for civil injunctive and mandamus relief to prohibit future violations of the securities laws and, in the words of subsection (e), to command compliance with the securities laws in preventing illegal practices. While Section 27, 15 U.S.C. § 78aa (1982), refers to the general equity power of the federal courts, that power is specifically not mentioned in Section 21 as being available to the SEC in actions it is legislatively authorized to commence.

The Second Circuit's position that disgorgement is a remedy available to the SEC, a position it has held since its decision in *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971), is based on its view that a court may award such relief under its general equity powers (A23-24). This position is inconsistent with the decision of the Ninth Circuit in *United States* v. *Parkinson*, 240 F.2d 918 (9th Cir. 1956), which refused to allow the use of the court's equity powers in precisely the way those powers were exercised here. The Ninth Circuit, refusing to allow restitution sought by the Food and Drug Administration, explained its position as follows:

> "It is particularly urged upon us that a court of equity has power to fashion remedies to meet situations and to compel compliance with decrees. To a certain extent this is correct in litigation between private individuals. But Chancery has ceased for long ages to

> issue new writs whereby supposed wrongs could be cured. Such objectives are modernly to be accomplished only by legislation. Hundreds of years ago, likewise, equity ceased to be the measure of the 'King's foot.'
> . . . .
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> * * *
>
> "When Congress authorizes the enforcement by an administrative body, of rules, regulations or orders promulgated by it, the history of equity and the Court of the Star Chamber in this type of litigation should not be forgotten. *The use of the extraordinary remedies of equity in governmental litigation should never be permitted by the courts unless clearly authorized by the statute in express terms.* Anything which savors of a penalty should not be permitted unless Congress has *expressly* so provided, since the spirit of equity abhorred such punitive measures."

Id. at 921-22 (emphasis added).

The full panoply of equitable remedies available to the Chancellor was not given to the SEC. The statutory scheme specifically permits the SEC to obtain only injunctive and mandamus relief, and not generally "equitable" relief. While the Second Circuit has frequently affirmed the award of disgorgement in Section 10(b) insider trading cases, it has done so with the clear recognition that in allowing disgorgement it "is exercising the chancellor's discretion to prevent unjust enrichment." *SEC v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 95 (2d Cir. 1978), and to deter future violations, *e.g.*, *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972).

As salutary as these purposes may have been, particularly in keeping with the earlier mandates of this Court that the courts were to construe the rights and remedies given by the securities laws broadly, this approach has no place under the specific enabling provisions of Section 21 and the teaching of *Blue Chip*, *Hochfelder*, *Chris-Craft*, *Santa Fe* and *Chiarella*, all of which

reflect a more restrictive view of the scope and application of the federal securities laws than the decisions on which *Texas Gulf Sulphur* and its progeny were based. These more recent decisions are premised upon the proposition that it is the statute itself rather than the courts' views of how to effectuate its remedial goals which must govern.

The Second Circuit's decision is also contrary to the recent pronouncement of this Court in *Tull v. United States*, 107 S. Ct. 1831, 1839 (1987), that disgorgement is a "remedy only for restitution . . . limited to 'restoring the status quo . . . .' " Not only was there no showing below that there were any damaged investors who were suing for restitution, but under the Second Circuit's previous decision in *Moss v. Morgan Stanley Inc.*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984), any shareholder damaged by selling the same stock as the alleged insider purchased would have no claim for damages in the absence of a duty of disclosure the alleged insider owed to him. In any event, no such suits have been brought and none could be brought hereafter since they are time-barred, the events giving rise to any damage claim having occurred in March 1981, more than six years ago. The decision below orders disgorgement of almost $2,000,000, which will never go to any injured party and will likely remain with the SEC. Disgorgement in these circumstances is nothing more than a penalty, which is clearly improper. *Texas Gulf Sulphur*, 446 F.2d at 1308 (disgorgement must be remedial and "not a penalty assessment"); *Manor Nursing Centers*, 458 F.2d at 1104 (same). As there is no one available to receive restitution, the judgment directing disgorgement must be reversed.

CONCLUSION

For the foregoing reasons Lombardfin S.p.A. and Paolo Mario Leati respectfully request that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Dated: New York, New York
February 8, 1988

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1098, 1099—August Term 1986

Argued: April 10, 1987 Decided: November 20, 1987

Docket Nos. 86-6192(L), 86-6194, 86-6196

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

—against—

GIUSEPPE B. TOME, PAOLO MARIO LEATI, LOMBARDFIN S.p.A., TRASATLANTIC FINANCIAL CO., S.A., NAYARIT INVESTMENTS, S.A., FINVEST UNDERWRITERS AND DEALERS CORP., CERTAIN PURCHASERS OF THE COMMON STOCK AND CALL OPTIONS FOR THE COMMON STOCK OF ST. JOE MINERALS CORP., and BANCA DELLA SVIZZERA ITALIANA,

Defendants,

PAOLO MARIO LEATI, LOMBARDFIN S.p.A., TRASATLANTIC FINANCIAL CO., S.A., NAYARIT INVESTMENTS, S.A., and FINVEST UNDERWRITERS AND DEALERS,

Defendants-Appellants.

Before:

LUMBARD, OAKES, and CARDAMONE,
Circuit Judges.

Two appeals from a judgment entered in the Southern District by Judge Milton Pollack, holding appellants liable for violations of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder and directing disgorgement of profits from their insider trading.

Affirmed.

RICHARD A. KIRBY, Assistant General Counsel, Securities and Exchange Commission, Washington, D.C. (Paul Gonson, Solicitor, Daniel L. Goelzer, General Counsel, Jacob H. Stillman, Associate General Counsel, Thomas L. Riesenberg, Special Counsel, Martha H. McNeely, Katharine B. Gresham, Randall W. Quinn, Attorneys, Securities and Exchange Commission, Washington, D.C., of counsel), *for Plaintiff-Appellee.*

PAUL J. BSCHORR, New York, N.Y. (White & Case, New York, N.Y., Robert M. Kelly, Dorothea W. Regal, Loreto Ruzzo, Bar-

bara Shea, of counsel), *for Defendants-Appellants Lombardfin S.p.A. and Paolo Mario Leati.*

BRUNO SCHACHNER, New York, N.Y., *for Defendants-Appellants Nayarit Investments, S.A., Trasatlantic Financial Co., S.A., Finvest Underwriters and Dealers Corp.*

LUMBARD, *Circuit Judge*:

On March 10, 1981, one day before Joseph E. Seagram & Co. ("Seagram") announced a hostile tender offer for St. Joe Minerals Corporation ("St. Joe"), Giuseppe B. Tome and his associates ordered massive purchases of St. Joe securities. Less than three weeks later, the SEC filed this suit originally charging Banca Della Svizzera Italiana ("BSI"), Irving Trust Company and "certain purchasers of call options for the common stock of St. Joe Minerals Corporation" with violations of the anti-fraud provisions of the federal securities laws. The complaint was amended on several occasions and ultimately named Tome, three Panamanian corporations in which he owned a beneficial interest (Trasatlantic Financial Co., S.A., Nayarit Investments, S.A., and Finvest Underwriters and Dealers Corp. (collectively the "Panamanian corporations" or "Panamanian defendants")), the "certain purchasers", Paolo Mario Leati, Lombardfin, S.p.A. and BSI as defendants.

After a bench trial on October 23, 1985, in the Southern District of New York, Judge Milton Pollack found

that the defendants had violated sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78n(e) and Rules 10b-5 and 14e-3. *SEC v. Tome*, 638 F. Supp. 596 (S.D.N.Y. 1986). By a judgment entered on July 22, 1986, Judge Pollack enjoined the defendants from violating the antifraud provisions of the federal securities laws and ordered them to disgorge over $2.7 million in profits obtained through trading on non-public information (plus over $1.3 million in prejudgment interest). The Panamanian corporations[1] and Leati and Lombardfin appeal from that judgment.

Leati and Lombardfin claim that the district court lacked personal jurisdiction over them because of defects in the service of process. The Panamanian corporations join them in making three additional arguments: (1) they challenge the admissibility of the deposition testimony of Dionisio G. Csopey; (2) they attack the sufficiency of the evidence; and (3) they contend that the district court improperly ordered disgorgement of their profits. We affirm.

We summarize the salient facts, more fully recorded in the district court's opinion. The case of the Securities and Exchange Commission focused on Giuseppe B. Tome, an Italian national now residing in Switzerland. Tome began working as a registered representative in the securities industry at the Milan office of Bache & Co. in 1959. He moved to E.F. Hutton & Company, Inc. where he eventually became president of E.F. Hutton, International,

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1 On November 25, 1986, we granted the SEC's motion to dismiss Tome's appeal because he was, and still is, a "fugitive from justice," but denied the same motion as to the Panamanian defendants. We deny the SEC's request to reconsider the denial of its motion to dismiss the appeal of the Panamanian defendants.

S.A., and a director of E.F. Hutton & Company, Inc. In 1979, Tome resigned from Hutton and formed his own investment company, Compagnie Pour le Financement et l'Investissement, S.A. (Finvest Geneva) in Geneva, Switzerland. Tome is also a beneficial owner of the defendant Panamanian corporations. In March 1981, when the illegal transactions took place, he enjoyed discretionary power over their accounts at BSI, a Swiss bank based in Lugano, Switzerland.

Paolo Mario Leati is a sales representative and Lombardfin is a broker/dealer both of whom are registered with the SEC. In 1974, Leati, an Italian national living in Italy, and Dionisio G. Csopey left Merrill Lynch, Pierce, Fenner & Smith, Inc. and formed Lombardfin, S.p.A., a holding company whose subsidiaries and affiliates engage in securities and currency brokerage. Leati—the majority shareholder of and primary decisionmaker for Lombardfin—wielded discretionary authority over many of his clients' accounts. Finvest Geneva and Lombardfin, and consequently Tome and Leati, enjoyed a close working relationship evinced by office rental agreements, brokerage contacts, and other business arrangements.

In July, 1980, Tome met Edgar M. Bronfman, Chairman of the Board and Chief Executive Officer of Seagram, when the two flew on the Seagram company plane to a rodeo in Cheyenne, Wyoming. Tome subsequently developed a business relationship with Bronfman and in October, 1980, Tome, acting for Finvest Geneva, agreed to provide Seagram with information and advice about foreign currencies. In the same month, Finvest Geneva agreed to invest and manage ten million dollars for Seagram in various currencies, bonds and notes. Bronf-

man also opened a personal account at Finvest Geneva, over which he gave Tome discretionary authority.

In August, 1980, Seagram sold its interest in Texas Pacific Oil Company for $2.3 billion. With this cash reserve and a $3 billion line of credit, Seagram began looking for an acquisition candidate. Because of Bronfman's interest in coal as a primary energy source, Seagram focused on companies with significant coal assets, particularly Santa Fe Industries, Amax, St. Joe, and Union Pacific. In late 1980, Tome requested and received from Seagram a briefing on its policies, operations, and financials.

In making acquisition decisions, Bronfman "consider(ed Tome) sort of a European consultant to Seagram generally," 638 F. Supp. at 603, and looked to him for insight into how the European investment community would view an acquisition by Seagram. "Tome seized and actively solicited and nurtured this confidentiality, frequently probing into the internal reasons for Seagram's actions, asking Bronfman 'why?' " 638 F. Supp. at 603. In mid-December, 1980, Bronfman informed Tome that Seagram was looking "very hard" at Santa Fe and sought Tome's advice on the proposed acquisition. This conversation indicated to Judge Pollack that "Tome was looked upon and treated by Bronfman as an insider of Seagram, as he had become." *Id.* at 604. Tome probed why Seagram was interested in Santa Fe and when Bronfman expected to act. Bronfman testified that he and Tome "didn't just discuss Santa Fe, but companies like Santa Fe," and that he might even have mentioned Seagram's short list of potential acquisition candidates—Santa Fe, Amax, and St. Joe.

On January 13, 1981, the board of Seagram's parent corporation authorized Seagram to invest up to $150 million in the stock of four companies, without being informed that the companies were Santa Fe, Amax, St. Joe, and Kimberly Clark. On January 28, Seagram decided not to proceed with the acquisition of Santa Fe. Bronfman conveyed this information to Tome by February 6, at the latest. In early February, Seagram also dropped Amax from the potential acquisition list. Bronfman could not remember whether he informed Tome that Amax had been removed from Seagram's acquisition list. According to Bronfman, "[a]lmost by a process of elimination, that left St. Joe." By February 25, 1981, Bronfman had decided to make a tender offer for St. Joe.

The price and volume of St. Joe securities trading remained relatively stable during February and March. Moreover, two weeks prior to Seagram's tender offer, Salomon Brothers & Co., a highly respected New York broker-dealer, executed sales of a large block of St. Joe stock on behalf of an institutional client. Apparently, Seagram's intentions were a well-kept secret.

Bronfman and Tome continued to see each other socially: They participated in a "joint venture" as investors in the Broadway musical "Sophisticated Ladies;" Bronfman, Tome and their wives spent vacations together in France, Virginia, and Mexico; and they talked frequently by telephone. On March 9, 1981, Tome called Bronfman in New York and invited him to dinner the following evening. Bronfman declined Tome's dinner invitation, stating that he would be in Montreal for a directors' meeting.

The next morning, March 10, 1981, Tome feverishly placed orders for St. Joe securities. Through BSI, Tome

purchased 1,055 options[2] on St. Joe common stock on behalf of the Panamanian corporations. Tome bought an additional 3,000 shares of St. Joe stock through Finvest Geneva on behalf of Finvest Underwriters and Dealers Corp. Tome later sold 2,000 of these shares, reaping an overnight profit of $34,000 and exchanged the other 1,000 shares of St. Joe stock for 1,200 shares of Fluor Corporation. The trading profits were deposited in BSI's account at Irving Trust. On the morning of March 11, Seagram's public announcement of the tender offer foiled Tome's efforts to place orders for an additional 2,055 call options.

Tome also made numerous phone calls on March 10 to individuals at various foreign financial institutions urging them to purchase St. Joe securities. After telephone calls from Tome, Banque de Rone, a Swiss bank in Geneva, purchased 200 St. Joe shares and 50 St. Joe call options; Cramer, a Swiss bank client, bought 100 St. Joe call options and 1,000 St. Joe shares; and Compagnie de Banque et d'Investissements, another Swiss bank client, placed orders for 150 St. Joe call options and 1,100 shares. On the same day, Banque Gutzwiller and Trade Development Bank (TDB), both clients of Tome, bought 2,000 and 13,000 St. Joe shares respectively. Although Gutzwiller and TDB never received phone calls from Tome, the district court concluded that "Tome conveyed the inside information that he possessed to Gutzwiller and to TDB, and that they subsequently traded and profited personally on that information." 638 F. Supp. at 610.

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2 Each option gives the purchaser the right to buy 100 shares of the underlying stock on terms provided in the option.

Tome also called Leati in Milan on March 10. Two minutes after hanging up, Leati exercised his discretionary authority over his clients' accounts and began purchasing St. Joe securities. Before March 10, Lombardfin had never purchased or sold a single share of St. Joe. By the end of the day, Lombardfin had purchased 40,200 shares of St. Joe common stock and 500 St. Joe call options, which it subsequently liquidated for a net profit of $1,345,925.

According to Leati, Tome said only "I'd buy [St. Joe]" when he telephoned. However, Leati's partner, Dioniso Csopey, told a different story, which the district court credited. Csopey testified that on March 10, Leati mentioned that he had learned from Tome that Seagram would make a tender offer for St. Joe in a few days. Leati agreed to pay Tome $200,000 for this information, if a takeover in fact took place. Leati believed that Tome's claims "could well be true" because of Tome's close personal relationship to Seagram. With Csopey's assent, Leati placed additional orders for St. Joe securities on March 11, which were never executed because of the announcement of the tender offer. The next day Leati told the board of directors of Lombardfin of his agreement with Tome, admitted that Lombardfin had committed securities violations, but downplayed the risk of being caught.

Altogether, Tome and his confederates purchased call options on 185,500 shares of St. Joe stock, one-third of all such options traded at the Philadelphia Stock Exchange on March 10. The bulk of the options bought by Tome expired 11 days after they were purchased. They also bought at least 60,500 shares of St. Joe common,

representing 10.67% of the total volume in St. Joe stock sold on the New York Stock Exchange on March 10.

At 7:00 p.m. on March 10, the board of directors of Seagram's parent company held a special meeting. The meeting had been scheduled for the following day, but it was changed because of activity in St. Joe stock. At that meeting, the parent company authorized Seagram to make a tender offer for St. Joe. At 9:22 a.m. the following morning, March 11, Seagram announced publicly its bid for St. Joe and its stock price soared.

In New York on the evening of March 11, Bronfman, Tome and their wives went to see "Sophisticated Ladies". Although they discussed Seagram's tender offer, Tome said nothing about his trading the previous day. That night Bronfman gave a dinner party for twenty people in Tome's honor. Again, the two discussed the tender offer and again Tome failed to mention his dealings in St. Joe securities. On March 12, Tome liquidated his St. Joe holdings and instructed his clients to do the same.

On March 13, the SEC publicly announced an inquiry into possible insider trading on the Seagram offer for St. Joe stock. Tome left New York and returned to Switzerland on March 14. The following day, Tome called BSI and asked them to rearrange the option purchases to make it appear that Finvest Underwriters had not purchased any St. Joe options. BSI refused.

The SEC commenced suit on Friday, March 27, 1981. The complaint named BSI and Irving Trust Company of New York, where the proceeds of BSI's trading in St. Joe had been deposited, as nominal defendants. The remaining defendants were identified by category as "certain

purchasers" of St. Joe call options. The district court ordered frozen BSI's account at Irving.[3]

The following Monday, March 30, Bronfman learned about the SEC investigation of alleged insider trading in St. Joe securities originating in Switzerland; he immediately phoned Tome. According to Bronfman, Tome was "the only person I knew in Switzerland that would have any knowledge one way or another of anything that was going on." At about 7:20 that night, Tome returned his call and denied any wrongdoing, but admitted that the matter was "a little more complicated than that." He promised to elucidate when he saw Bronfman in New York the following week.

On Monday, April 6, Tome visited Bronfman at his New York apartment. Tome acknowledged that one of his people had placed an order for 3,000 shares of St. Joe stock but claimed that he had not been personally involved. When Bronfman asked point blank, "Were those shares in any way beneficially owned by you or members of your family?" Tome responded, "No." Tome repeated his story the following morning in Bronfman's office, with Bronfman's attorney present. Judge Pollack noted that later "Tome's counsel conceded on the record that Tome had a beneficial interest in St. Joe stock purchases." 638 F.2d at 613 (footnote omitted).

Tome left the United States soon thereafter, missing a business meeting on April 9. He has not returned to the

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3 On November 18, 1986, BSI satisfied the district court's judgment, which ordered it to pay into the registry of the court $2 million—most of the Panamanian corporations' illegal profits plus interest. BSI has not appealed from that judgment and the Panamanian defendants lack standing to appeal in BSI's stead.

United States since 1981, and has refused to appear in this action or related criminal proceedings.

I. SERVICE OF PROCESS

Leati and Lombardfin contend that the district court did not have personal jurisdiction over them because they never received valid service of process. When the SEC instituted this suit on March 27, 1981, it was aware only that a substantial number of the March 10th trades in St. Joe securities had been conducted through BSI. Swiss bank secrecy laws prevented the SEC from ascertaining the identities of the individual purchasers involved. Therefore, the original complaint named only BSI, Irving Trust (where BSI had deposited the proceeds of the trades) and "Certain Purchasers of Call Options for the Common Stock of St. Joe Minerals Corporation" as defendants. These purchasers were defined in the complaint as "certain persons, the identities and addresses of whom are unknown to the plaintiff at this time." On November 12, 1981, BSI, facing contempt sanctions, informed the SEC that Tome and the Panamanian defendants had ordered purchases of St. Joe securities during the period in question. The SEC amended the complaint on December 14, 1981 to include Tome and the Panamanian corporations as defendants.

During its subsequent investigation of Tome's involvement, the SEC learned that on March 10, 1981, Tome had telephoned several foreign financial institutions, including Lombardfin, and that these institutions had purchased St. Joe securities immediately after these telephone conversations took place. Leati submitted an

affidavit to the SEC[4] taken in Milan dated April 28, 1982, in which he admitted that he purchased St. Joe securities on March 10, 1981 through Lombardfin but denied knowingly trading on nonpublic information. He also submitted his records of those trades to the SEC. The Lombardfin trading records indicated that the St. Joe transactions were "unsolicited"—in other words, that the trades were executed without use of Leati's discretionary authority over the accounts. Unbeknownst to the SEC at that time, the information contained in the Leati affidavit and the Lombardfin records was false.

The SEC filed a second amended complaint on May 13, 1982, which expanded the category of "certain purchasers" to include persons, whose identities were unknown to the SEC and who had effected transactions in St. Joe securities through a number of foreign banks and securities dealers, including Lombardfin. At this point the SEC had no evidence suggesting that Leati and Lombardfin had knowingly participated in illegal trades, therefore, they were not named as defendants in the second amended complaint.

The record reflects the many difficulties that the SEC experienced in attempting to serve process on Tome and the Panamanian defendants. Due to these difficulties and because the identities of the other purchasers remained unknown despite diligent efforts, the SEC sought an order pursuant to Fed. R. Civ. P. 4(i)(1)(E) (which allows service on a foreign defendant "as directed by order of the court") authorizing service on all defendants by publication of the complaint and summons in the *International Herald Tribune* and *La Suisse*. Judge Pollack granted the

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4 The record does not show the circumstances under which the affidavit was submitted.

motion by order on May 13, 1982. The *International Herald Tribune* is an English language paper which is widely read by the international financial community in Europe; *La Suisse* is a French language paper circulated in and around Geneva. When it was discovered that publishing the complaint and summons in *La Suisse* would violate Swiss law, the order was amended and the complaint and summons were published in all editions of the *International Herald Tribune* for four successive weeks.

On September 4, 1985, the SEC deposed Dionisio Csopey, Leati's former partner, pursuant to a subpoena in New York. Csopey's deposition testimony revealed that the affidavit and trading records submitted by Leati to the SEC were misleading. According to Csopey, when Tome called Leati on March 10, he told Leati that "Seagrams would make, in the next few days, make a tender offer for St. Joe Minerals." 638 F. Supp. at 615. Leati told Csopey that Tome was passing this information on to Lombardfin in exchange for $200,000, if the tender offer in fact occurred. Csopey also testified that during a Lombardfin board of directors' meeting on March 11, 1981, Leati explained the circumstances surrounding the St. Joe transactions and admitted that the firm had committed securities violations by trading on inside information. However, he "downplayed the risk of being caught by remarking that Lombardfin S.p.A. had accounted for only a 'small fraction' of the previous day's total trading volume." *Id.* at 616.

During Letter Rogatory proceedings (authorized by the district court in September 1985) in Milan, Italy on October 2, 1985, Leati for the first time admitted that some of the trades he executed on March 10, 1981

involving St. Joe securities were not "unsolicited" and that Tome had told him to buy St. Joe. The testimony at the Letter Rogatory proceedings and the Csopey deposition testimony established that Leati was involved in the insider trading scheme with Tome. The SEC then sought to amend the second amended complaint to identify Leati and Lombardfin by name as among the group referred to as "certain purchasers" on the face of the complaint. This amendment made no changes in the allegations contained in the body of the complaint. On October 17, 1985, the district court issued an "Order to Show Cause Why Leave to Amend . . . Complaint in respect of the 'Purchasers' and to substitute therefor in part the names of . . . [Leati] and Lombardfin . . . should not be granted." The order required Leati and Lombardfin to show cause at the United States Courthouse at 10:00 a.m. on October 23rd, "or as soon thereafter as counsel can be heard." On October 18, a member of the Italian bar personally delivered the order on behalf of the SEC to Leati and Lombardfin at their office in Milan.[5] At the commencement of the trial on October 23, 1985, Judge Pollack heard the SEC's motion to amend the complaint to identify Leati and Lombardfin as two of the "certain

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5 Francesco Abbozzo handed envelopes containing the order to show cause, the affidavit in support of the order, and the memorandum in support of the application for the order and leave to amend the complaint to Leati at 12:45 p.m. on October 18 in Milan. The same documents were also delivered to Leati's and Lombardfin's attorney at 12:50 p.m. Several pages of the affidavit and memorandum were missing due to transatlantic transmission problems. Abbozzo informed Leati of the omissions and indicated that he would return with the missing pages. At approximately 4:45 p.m., Abbozzo delivered complete copies of the documents to a secretary at Lombardfin. Leati then emerged from an office and ejected him from the premises. Complete copies were also delivered to Leati's counsel the same day.

purchasers" named as defendants. Leati and Lombardfin elected not to appear at either the hearing or the trial. Judge Pollack found that the 1982 service by publication coupled with the evidence that Leati and Lombardfin "clearly were aware of the pendency of this litigation but chose not to participate in it" satisfied the notice and service requirements and concluded that because Leati and Lombardfin had already been charged as unknown defendants in 1982, substitution of their names on the complaint was not a substantive amendment requiring reservice of the complaint. On July 22, 1986, the district court entered judgment holding Leati and Lombardfin liable for violations of the anti-fraud provisions of the securities laws. Leati and Lombardfin now challenge the district court's jurisdiction. We reject their challenge.

To submit a party to the jurisdiction of a court, due process has long been held to require the giving of notice in such a manner that there can be little doubt that the party has actual notice of the claims in order to appear and defend. *Wuchter v. Pizzutti*, 276 U.S. 13, 24 (1928). Where the plaintiff can show that deliberate avoidance and obstruction by the defendants have made the giving of notice impossible, statutes and caselaw have allowed substitute notice by mail and by publication in media of general and wide circulation. Thus, as business dealings have become increasingly interstate and international, the means of giving notice have been extended to meet these situations, so that parties may be held accountable in our courts of justice.

Gradually we have come to permit and approve the giving of notice under a substitute system limited by the requirements of the due process clause. "An elementary and fundamental requirement of due process in any

proceeding which is to be accorded finality is notice reasonably calculated, under the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane v. Central Hanover Bank and Trust Co.*, 339 U.S. 306, 314 (1950). Publication of the complaint and summons in the *International Herald Tribune* was "reasonably calculated" to notify the unidentified purchasers of St. Joe options, including Leati and Lombardfin, of the suit against them. The SEC was aware that the illegal trades had been effected through several European financial institutions, yet its efforts to identify the guilty parties were thwarted by Swiss secrecy and other foreign laws. The SEC reasonably concluded that the purchasers resided or conducted business in Europe and chose a publication likely to be read by international investors. The propriety of this method of notice must also be considered in light of the fact that members of the securities industry like Leati and Lombardfin may be expected to be aware of a publicly announced SEC investigation involving insider trading during a high-visibility takeover. The facts here are distinguishable from cases where notice was published in a small regional paper or the advertisement contained nothing which would draw a party's attention to it. *E.g.*, *Mullane*, 339 U.S. at 315. Notice by publication, in the circumstances surrounding this action, was reasonably calculated to apprise the interested parties of the lawsuit.

The "reasonably calculated" analysis need not be relied on exclusively in this case because we are not dealing with the question of the adequacy of *constructive notice*. There can be no doubt that by October 23, 1985 when the matter was tried before Judge Pollack, Leati and Lom-

bardfin knew of the suit brought by the SEC and the claims against them.[6] In fact, they were cognizant of the action years before the SEC discovered evidence of their involvement. As a registered representative, Leati realized on March 10, 1981 that he was committing a serious violation of the United States securities laws by trading on inside information. The next day he explained to the Lombardfin board of directors that the St. Joe trades were illegal, but downplayed the risk of being caught. Tome visited the Lombardfin offices regularly throughout 1981. During this time, he and Csopey had discussions about the size of the legal fees for all involved in this action. Leati told Csopey that Tome had pressed him "for contributions to the legal fees and to a pool which would settle the case." 638 F. Supp. at 616. Leati's submission to the SEC of a false affidavit of April 28, 1982 and misleading trading reports designed to obscure his involvement in the illegal transactions provide further evidence that he was fully aware that he was among those referred to as "certain purchasers" on the face of the complaint and that he understood the nature of the suit and the charges against him. Prior to obtaining the information from the Csopey deposition and the Letter Rogatory proceedings, the SEC sought the cooperation of Leati and Lombardfin to determine the cirumstances of the trades and the persons involved. Leati and Lombardfin declined to cooperate and Lombardfin's legal counsel refused to accept service of an SEC investigative sub-

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6 The SEC moved to supplement the record on appeal, or, in the alternative, to remand to the district court, in order to produce evidence that Leati and Lombardfin took notice of the complaint and summons published in the *International Herald Tribune*. In view of our finding that Leati and Lombardfin received proper notice, we deny the motion.

poena. Leati and Lombardfin also petitioned the Italian court in August of 1985 to set aside the district court's Letter Rogatory and refused to produce any documents thereby requested. On October 18, 1985, five days before trial was to begin, Leati was personally served with a copy of the order to show cause why he and Lombardfin should not be named as defendants in this case. With full knowledge of the pendency of the action against them, Leati and Lombardfin elected not to appear. They raise their objections for the first time in this appeal.

Leati and Lombardfin claim that because the SEC admittedly knew their names and addresses when notice was published in the *International Herald Tribune*, such service was invalid. *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 800 (1983); *Mullane*, 339 U.S. at 320. Certainly, if a defendant's name and address are known or may be obtained with reasonable diligence, service by publication will not satisfy the requirements of due process. *Mennonite Bd. of Missions*, 462 U.S. at 800. However, this is not such a case. Although Leati and Lombardfin were well aware that they were among those named on the complaint as "certain purchasers" in this action, the SEC was not. Leati's affidavit and the misleading trading records deceived the Commission into believing that they were not involved in Tome's scheme. The SEC was unaware of the the nature of their involvement until September of 1985. Thus, at the time that Judge Pollack authorized service on the "purchasers" by publication, Leati and Lombardfin were "unknown defendants" whose identities could not have been ascertained with reasonable diligence by the SEC. *Id.* As the Supreme Court pointed out in *Mullane*, "in the case of persons missing or unknown, employment of an indirect

and even a probably futile means of notification is all that the situation permits and creates no constitutional bar to a final decree foreclosing their rights." *Mullane*, 339 U.S. at 317.

"The fundamental requisite of due process of law is the opportunity to be heard." *Grannis v. Ordean*, 234 U.S. 385, 394 (1914). This record clearly establishes that Leati and Lombardfin were afforded such an opportunity and that they made a conscious decision to ignore this action until after a judgment had been rendered against them.

II. ADMISSIBILITY OF CSOPEY'S TESTIMONY

All appellants challenge the admissibility of the deposition testimony of Dioniso G. Csopey, Leati's former partner at Lombardfin, which was introduced into evidence at trial in lieu of his appearance. The district court admitted Csopey's testimony, over objection, under the co-conspirator exception to the hearsay rule. Fed. R. Evid. 801(d)(2)(E). *SEC v. Tome*, 638 F. Supp. 629 (S.D.N.Y. 1986). The Panamanian defendants contend that the testimony is inadmissible because (1) there was no extrinsic proof of the existence of a conspiracy between Leati and Tome; (2) Leati's statements to Csopey were not made in furtherance of the conspiracy; and (3) there was no showing they were co-conspirators with Leati. We disagree.

First, there was ample evidence that Tome and Leati were co-conspirators. They had a close working relationship, and it was immediately after the phone call from Tome that Leati began placing large orders for St. Joe securities. Second, when Leati made the statement to Csopey, he was trying to convince Csopey to assist him in

making additional St. Joe purchases on March 11, 1981. *Id.* at 636. The district court could reasonably conclude that Leati made the statements "in furtherance" of the conspiracy. *See United States v. Rahme*, 813 F.2d 31, 35-36 (2d Cir. 1987). Third, because the Panamanians were Tome's alter egos, the district court properly treated them as co-conspirators.

There is no merit to Leati and Lombardfin's contention that Csopey's testimony was inadmissible against them because they were not given notice of his deposition. As discussed above, in September 1985 when Csopey's deposition was taken, Leati and Lombardfin were aware of the action and that they were among the category of purchasers named in the complaint. When they chose to ignore the action, they forfeited their right to attend Csopey's deposition and to object to its admission at trial. They may not make their objection for the first time on appeal. *See, e.g., United States v. Mangan*, 575 F.2d 32, 44 (2d Cir.), *cert. denied*, 439 U.S. 931 (1978). Csopey's deposition was taken under oath after notice was given to the named defendants. There is nothing in the record to suggest that Judge Pollack's decision to admit the testimony at trial was improper.

III. SUFFICIENCY OF THE EVIDENCE

Defendants' claims of insufficient evidence are without merit. The SEC introduced overwhelming evidence that Tome traded on material nonpublic information in breach of his fiduciary duties to Seagram in violation of Rule 10b-5. Through his confidential relationship with Bronfman and Seagram, Tome was privy to information not yet made public; one day prior to the announcement of the

takeover, and the morning after having a conversation with Bronfman, Tome began frantically trading in St. Joe securities and advised his clients and friends to do likewise; trading by Tome and his associates accounted for one-third of the activity in St. Joe call options on the Philadelphia Stock Exchange and 10% of the activity in St. Joe common stock on the New York Stock Exchange one day prior to the announcement of Seagram's tender offer; and Tome purchased one of the most speculative types of security available—call options due to expire in 11 days.

Finally, Tome went to great pains to cover-up his trading. He traded through BSI, a Swiss bank protected by Swiss secrecy laws, although he would have received a discount on brokerage fees had he dealt through Baird-Patrick & Co., Inc. where he was a registered representative. He repeatedly misled Bronfman about his activity in St. Joe securities, and he fled the United States soon after this action began. Thus, Judge Pollack's findings were amply supported by the record.

We also agree with Judge Pollack that the evidence showed that Leati and Lombardfin knew that nonpublic information had been divulged to them in breach of a fiduciary duty. *Dirks v. SEC*, 463 U.S. 646, 660 (1983). Csopey testified that Leati told him that he had agreed to pay Tome $200,000 for information that Seagram was about to make a tender offer for St. Joe. Leati made the large purchases of St. Joe stock immediately after talking with Tome, indicating his belief in the reliability of Tome's information. He told Csopey that he believed that the information "could well be true" because of Tome's ties to Seagram. At a Lombardfin board meeting on March 11, Leati admitted that his trades in St. Joe

securities on the previous day had "obviously" been "a violation" of the United States securities laws. And, after the SEC commenced this action, Leati attempted to deceive the Commission by submitting a false affidavit with doctored trading records.

Leati and Lombardfin also complain that there was insufficient evidence to support an injunction against them. Judge Pollack found that there was a likelihood of recurrence because Leati had intentionally misappropriated inside information, had shown no remorse for doing so, had attempted to mislead the SEC, and because Leati had the opportunity to repeat his conduct in the future because of his position as a registered securities sales representative. We agree. There was "positive proof of a reasonable likelihood that past wrongdoing [would] recur" necessary for an injunction. *SEC v. Bausch & Lomb, Inc.*, 565 F.2d 8, 18 (2d Cir. 1977); *see, e.g., SEC v. American Board of Trade, Inc.*, 751 F.2d 529, 537-38 (2d Cir. 1984). An injunction also properly issued against Lombardfin which is dominated by Leati as its owner and manager.

IV. DISGORGEMENT

The appellants claim that the district court erred in ordering disgorgement of the proceeds of the illegal trades. They contend that the disgorgement remedy's only purpose is to provide restitution for victims of the illegality. In *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90 (2d Cir. 1978), Judge Friendly explained that "the primary purpose of disgorgement is not to compensate investors. Unlike damages, it is a method of forcing a defendant to give up the amount by which he was un-

justly enriched." *Id.* at 102.[7] As the Sixth Circuit has recently stated in *SEC v. Blavin*, 760 F.2d 706, 713 (6th Cir. 1985) "[o]nce the Commission has established that a defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without inquiring whether, or to what extent, identifiable private parties have been damaged by [the] fraud." *Id.* Whether or not any investors may be entitled to money damages is immaterial. The paramount purpose of enforcing the prohibition against insider trading by ordering disgorgement is to make sure that wrongdoers will not profit from their wrongdoing. Tome and his satellites must therefore "disgorge a sum of money equal to all the illegal payments [they] received." *Id.*

The judgment of the district court is affirmed.

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7 We do not believe the Supreme Court's passing reference to the restitutionary nature of the disgorgement remedy in *Tull v. United States*, 107 S. Ct. 1831, 1839 (1987), was meant to cast doubt on the propriety of disgorgement in cases such as this. *Tull* dealt not with the power of a district court to order disgorgement in securities fraud actions, but with the right to a jury trial in an action seeking civil penalties and injunctive relief under the Clean Water Act. However, *Tull* answers the Panamanian defendants' argument that they had a right to a jury trial; the Seventh Amendment right to a jury trial does not apply to the equitable actions for disgorgement. *Id.*

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,

v.

Giuseppe B. TOME, Paolo Mario Leati, Lombardfin S.p.A., Trasatlantic Financial Co., S.A., Nayarit Investments, S.A., Finvest Underwriters and Dealers Corp., Certain Purchasers of the Common Stock and Call Options for the Common Stock of St. Joe Minerals Corp., and Banca Della Svizzera Italiana, Defendants.

No. 81 Civ. 1836(MP).

United States District Court,
S.D. New York.

June 3, 1986.

As Amended July 15, 1986.

Ira Lee Sorkin, Regional Administrator, S.E.C. by Anne C. Flannery, Robert B. Blackburn, Joseph G. Mari, Philip M. Giordano, Jennifer M. Russell, for plaintiff,

John F.X. Peloso, Daniel B. McIntyre, Sage Gray Todd & Sims, New York City, for defendant Giuseppe B. Tome.

Bruno Schachner, New York City, for defendants Transatlantic Financial Co., S.A., Nayarit Investments, S.A., Finvest Underwriters and Dealers Corp.

Chester J. Straub, David Trachtenberg, Willkie Farr & Gallagher, New York City, for defendant Banca Della Svizzera Italiana.

FINDINGS AND OPINION

MILTON POLLACK, Senior District Judge:

THE ACTION

This is a civil insider trading liability action, brought by the Securities and Exchange Commission ("SEC"), authorized by Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78u(d), seeking an injunction and other ancillary relief, including disgorgement of ill-gotten gains, against defendants based on defendants' violations of the antifraud provisions of the securities laws and regulations. Subject-matter jurisdiction is posited on Sections 21(e) and 27 of the Exchange Act, 15 U.S.C. §§ 78u(e) and 78aa.

This action arises from the defendants' purchases of call options on the common stock of St. Joe Minerals Corporation ("St. Joe"), as well as of the stock itself, on March 10, 1981, the day immediately prior to the announcement by Joseph E. Seagram & Company of a hostile tender offer for all of the outstanding common stock of St. Joe. The issues were presented to the Court at a Bench trial.

The case reveals a crass abuse and betrayal of a personal and professional relationship of trust and confidence for personal gain. The principal defendant, Tome, exploited his confidential relationship with Seagram and with its Chairman of the Board and Chief Executive Officer, Edgar Bronfman, to obtain and misuse nonpublic information of Seagram's preparations to bid for control of St. Joe at $45 per share of common stock. Acting a day ahead of the announcement of that bid, on March 10, 1981, Tome positioned himself and his tippees to garner millions of dollars in unlawful gains by purchasing vast quantities of call options on St. Joe stock, and the stock itself, which was trading at about $30 per share, from unsuspecting sellers while Seagram was putting the finishing touches on the as-yet unannounced bid. Within days after the March 11th announcement of the hostile tender offer, which sent the St. Joe stock up to over $45 per share and sky-rocketed the options accordingly, Tome and his tippees cashed

in on their St. Joe call options and common stock. Tome Fraudulently concealed his misappropriation of this confidential corporate information and his breach of the confidential relationship from Bronfman and from Seagram, falsely denying that he had made any St. Joe purchases and falsely denying any participation in the market when confronted and questioned specifically by Bronfman. As his identity in the illegal conduct came to light through a prompt SEC investigation, Tome fled this country and has remained abroad since. His conduct, and that of his cohorts, was meticulously pieced together by the SEC, resulting in this suit.

I. BACKGROUND

A. *Identity and Interrelationship of Defendants*

Those involved in the misconduct complained of form an intricate international web which needs to be detailed in order to understand its ramifications.

1. *Tome*

Giuseppe B. Tome ("Tome") is an Italian national who resides in Switzerland.[1] He first became involved in the securities industry in 1959 as a Registered Representative in the Milan, Italy office of Bache & Co. ("Bache"). Through the years, Tome was promoted within the Bache organization, eventually becoming Chairman of Bache & Co. (Overseas) S.A., located in Geneva, Switzerland. Tome left Bache in 1973 for a position as Vice President of E.F. Hutton & Company, Inc. ("Hutton"). At Hutton, Tome was involved with their international division, eventually managing several hundred registered representatives located in twenty-two offices worldwide. When he resigned from Hutton

[1] Unless a contrary time period is indicated, all of the factual information stated in this Opinion, although expressed in the present tense, applies to the relevant time period involved here, the latter part of 1980 through April 1981. In addition, all hours, unless otherwise noted, refer to Eastern Standard Time.

on February 3, 1979, Tome was President of E.F. Hutton International, S.A., and was on the Board of Directors of Hutton.[2]

Sometime after leaving Hutton in 1979, Tome formed Compagnie Pour le Financement et l'Investissement, S.A ("Finvest Geneva"), a securities firm headquartered in Geneva, Switzerland, of which he is the President and Chief Executive Officer. Finvest Geneva is controlled by, and is part of, a larger holding company, Infinvest Holdings, N.V., a Netherland Antilles corporation. *See infra* note 5.

In order to execute securities trades on the United States exchanges, Tome was also a registered representative from January 1980 until June 30, 1981, with Baird-Patrick & Co., Inc. ("Baird-Patrick"), a United States broker-dealer.[3] Tome forwarded, and sometimes himself initiated, orders to buy or sell securities traded on U.S. exchanges, primarily the New York Stock Exchange, for the accounts of his clients, or for companies affiliated with Finvest Geneva, to Baird-Patrick for execution.

Tome regularly visited the United States for periods of time for business and social reasons; in early April 1981, however, he

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[2] According to a former colleague and former close friend of Tome, Alain Cheneviere, whom Tome hired while at Bache and took with him when he moved to Hutton, Tome left Hutton suddenly, under contentious circumstances. When Tome left he asked Cheneviere to "almost quit immediately" and follow him to some then, as yet, vague new venture; Cheneviere refused and became quite upset when Tome told him, Tome's confidente, "a gigantic lie." Cheneviere is presently a Vice President of Hutton in its Geneva office.

[3] Apparently Tome was less than fully candid with Mr. Patrick Chairman of Baird-Patrick, concerning Tome's activities other than those on behalf of Baird-Patrick. Patrick did not know Tome was associated in any way with Finvest Geneva, except as the Baird-Patrick registered representative for that account. In addition, Patrick did not know that Tome, in fact, regularly executed option trades through A.G. Becker, another U.S. broker-dealer and a competitor of Baird-Patrick. Patrick did not consider it permissible, given Tome's relationship with Baird-Patrick, for Tome to put through option trades for his customers with A.G. Becker directly.

left the United States abruptly,[4] missing a scheduled business meeting on April 9, 1981. Tome was indicted in New York on *August 7, 1984*, charged with criminal violation of the securities laws. He has not been in the United States since 1981 and did not return to face the criminal charges. Although represented by counsel in this case, he refused to answer any interrogatories related to the transactions involved herein on the ground of the Fifth Amendment privilege against self-incrimination.

2. *Finvest Geneva*

Although not technically a defendant in this action, Finvest Geneva is discussed here next, both for purposes of clarity, and because of Tome's proprietary interest in and his use of Finvest Geneva in the matters involved herein.

Finvest Geneva belongs to a group of related enterprises (the "Finvest Group")[5] that, through Tome's design, were represented to potential clients as engaging in securities and commodities brokeraging, in trading and underwriting, Eurobond transactions, currency management, portfolio management, as well as in investment banking.

Finvest Geneva itself was founded by Tome in 1979; Tome is its majority shareholder and two banks, Banque Privee and Compagnie de Banque et D'Investissement ("CBI"), are minority

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[4] The SEC instituted this suit on March 27, 1981. At that time, however, the SEC did not know exactly who was responsible for the St. Joe trades. But the SEC did wish to speak to Tome since he was the registered representative on the St. Joe stock trades occurring through Baird-Patrick (approximately 3,000 shares). Although Tome was aware that the SEC wanted to talk with him, he did not volunteer to see them but in fact left the country before they were able to track him down.

[5] Infinvest Holdings, N.V., a Netherland Antilles corporation, owns 100% of Finvest Securities and Commodity Brokers Corp., 100% of defendant Finvest Underwriters and Dealers Corp. ("Finvest Panama"), and 32% of International Corporation for Financing and Investment in Mexico Ltd. Finvest Geneva is also controlled by, and is a part of, Infinvest Holdings, N.V. The 1981 Second Quarter Report to Infinvest Holdings shareholders was signed by Tome.

shareholders. Finvest Geneva's clients comprise Swiss banks, persons with accounts in Swiss banks, and depositors of Swiss banks. Finvest Geneva managed portfolios for approximately 25-30 clients. Finvest Geneva was run from day to day by Tome, and when he was not there, by either of two other employees, Mr. Del Pozzo or Mr. Bulletti.[6]

Finvest Geneva had discretionary authority over at least some of its clients' accounts. The only persons exercising discretion over clients' accounts, however, were Tome and, to a lesser extent, Del Pozzo and Bulletti.[7] Thus, without the client's advance knowledge, Tome would often buy and sell stock and/or options for a particular clients' account.

3. *Lombardfin S.p.A.*

Lombardfin S.p.A.,[8] a holding company for various subsidiaries and affiliates, engaged primarily in securities and currency brokeraging, was formed in 1974 by Paolo Mario Leati ("Leati") and Dionisio G. Csopey ("Csopey"). Lombardfin S.p.A. and Finvest Geneva had a close working relationship because of Leati's relationship with Tome. In fact, Lombardfin S.p.A.'s two principal foreign affiliates were renting their *only* office space from Finvest Geneva.[9] Conversely, Tome often visited the Milan office

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[6] Del Pozzo was Tome's assistant for prospecting and for the Mexican ventures. Bulletti coordinated the operating and administrative side of Finvest Geneva.

[7] According to Lawrence B. Franko, Professor of International Business Relations at The Fletcher School, Tufts University, who formerly was a consultant/employee of Finvest Geneva, "Mr. Tome essentially made the decisions [on currency management], and the people who executed the orders were executing his decisions."

[8] In 1980-81, Lombardfin S.p.A.'s Board of Directors consisted of Riccardo Argenziano (chairman), Leati (vice-chairman), Mr. Spadacini, and Csopey. Its officers were Leati (general manager), Csopey (manager), and Mrs. Patricia Arbucias (secretary & manager).

[9] In fact, according to Professor Franko, *see supra* note 7, Ms. Brax's "office" consisted merely of "an excess desk" and a telephone, with access to telex facilities.

(Footnote continued)

of Lombardfin S.p.A.'s domestic subsidiary and used its facilities (*e.g.*, telephone, telex machine, quotation machine) to conduct his business. In addition, Lombardfin Securities Underwriters, a Lombardfin S.p.A. 100% owned affiliate, executed trades in the Eurobond market on Finvest Geneva's behalf because Finvest Geneva did not have the capacity to clear trades. Finvest Geneva had a securities trading account with Lombardfin Securities Underwriters, Ltd., which was opened on or about September 28, 1979.

4. *Leati and Csopey*

Leati is an Italian national residing in Italy. In 1974, he and Csopey left their employment at Merrill Lynch, Pierce, Fenner & Smith, and formed Lombardfin S.p.A., as a joint stock company. In 1980-81, Leati was the majority shareholder (60-75%) in Lombardfin S.p.A. Csopey (12.5%) and Fiduciaria di Investimenti, a company, were the minority shareholders. Csopey was not named as a defendant in this action.

Leati was the decision-maker for Lombardfin S.p.A. and its subsidiaries. He had discretion over accounts of many Lombardfin S.p.A. clients and thus could, and often did, trade shares and/or options for a client's account without that client's advance knowledge or specific approval.

5. *BSI*

Banca Della Svizzera Italiana ("BSI") is a Swiss banking institution with principal offices in Lugano, Switzerland. It maintains securities trading accounts for customers. It acted for Tome's interests and the accounts of the so-called Panamanian defendants, *i.e.*, NICO, TFCO, and Finvest Panama, discussed next.

6. *NICO*

To acquire the St. Joe securities he purchased directly on March 10, 1981, Tome used the brokerage trading accounts maintained at

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Thus, this Lombardfin-Finvest Geneva relationship consisted of much more interaction than that of a mere sublessor-sublessee relationship.

BSI for three Panamanian entities in which Tome had a beneficial interest, namely NICO, TFCO, and Finvest Panama.

The first of these BSI accounts, Nayarit Investments, S.A. ("NICO"), is a Panamanian company which was formed on or about May 31, 1978. NICO's principal line of business is the management and administration of assets deposited in bank accounts. Tome provided NICO with investment advisory and management services, for which no fees were paid to Tome. Tome was a beneficial owner of and held discretionary authority and a power of attorney over the NICO account.

7. *TFCO*

The second of these trading accounts at BSI, Trasatlantic Financial Co., S.A. ("TFCO"), is a Panamanian company which was formed on or about March 25, 1980. TFCO's principal line of business is the management and administration of assets deposited in bank accounts. Here again, Tome provided TFCO with investment and advisory services, without fee. Tome was a beneficial owner of the TFCO account and held discretionary power over it.[10]

8. *Finvest Panama*

The third of the trading accounts at BSI, Finvest Underwriters and Dealers Corp. ("Finvest Panama"), is a Panamanian corporation that was formed on or about June 26, 1979. Tome has been a beneficial owner of the Finvest Panama account with BSI and has had discretionary power over it. *See supra* note 10.

As noted previously, *see supra* note 5, Finvest Panama is a wholly owned subsidiary of Infinvest Holdings, N.V. (*i.e.*, the Finvest Group), and thus is directly related to Finvest Geneva, and thus to Tome.

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[10] On March 15, 1981, after purchasing the St. Joe stock and options that form the subject of this action, Tome called Claudio Nesa, assistant manager of defendant BSI, and asked him to reallocate the option purchases from Finvest Panama to NICO and TFCO. Tome stated that the reason he was doing this was "to secure greater confidentiality within *his organization*." (emphasis added).

B. *The Confidential Relationship*

At the base of this suit, we find a personal acquaintance that flowered and bloomed into an intimate friendship and a professional association in which trust and confidence were reposed in Tome, of which he callously took shoddy and unlawful advantage.

Edgar M. Bronfman ("Bronfman") is the Chairman of the Board and Chief Executive Officer of Joseph E. Seagram & Co. ("Seagram"), an Indiana corporation, and of its parent corporation, Seagram Company Ltd., a Canadian corporation.

Bronfman met Tome in July 1980 when they flew together, as part of a group of fourteen people, on the Seagram Company airplane to Cheyenne, Wyoming to attend a rodeo. Bronfman's wife had met Tome and his wife earlier that month. The Tomes promptly ingratiated themselves, resulting in an invitation to accompany the Bronfmans on the trip to help Mrs. Bronfman celebrate her birthday.

Using his opportunity on the airplane, Tome turned to financial matters and discussed currencies with Bronfman. Using a reprint of an article written about him that he happened to have handy, Tome showed Bronfman his oft-repeated "insight" that any American corporation keeping all its accounts in U.S. dollars is thereby "going short" on other currencies.

Within weeks of this enticing initial discussion, Bronfman introduced Tome to Harold Fieldsteel, Seagram's chief financial officer. In a memorandum to Fieldsteel, dated August 5, 1980, immediately prior to a meeting between Tome and Seagram's officers on the topic of Seagram's currency position, Bronfman stated that Tome's "record warrants our taking a serious look at his firm's [*i.e.*, Finvest Geneva's] capabilities," and that Bronfman was "not at all interested in any defensive attitude on [Seagram's] part."

After the initial associations, Tome moved in on the Bronfmans and intensified the social relationship and his business approach.

In October 1980, through Tome's efforts, Finvest Geneva obtained as a major client Seagram with which it signed two agreements. On October 2, 1980, Tome, acting for Finvest Geneva, signed a "Foreign Exchange Advisory Agreement" with Seagram under which, in exchange for $100,000 annually (later reduced to $50,000), Finvest Geneva agreed to provide Seagram with information and advice regarding world currencies and to form for it a foreign exchange advisory committee, the members of which were to be selected by Finvest Geneva with Seagram's approval. On October 8, 1980, Tome, acting for Finvest Geneva, entered into an "Investment Management Agreement" with Seagram under which Finvest Geneva was given discretion to invest ten million dollars of Seagram's money in various currencies, bonds and notes, and to exchange it from one currency to another. As a management fee, Finvest Geneva would receive one-eighth of 1%, per quarter, of the average amount of funds held in the Seagram account.

Although not memorialized as a "formal" relationship, but clearly indicated by subsequent conduct, Bronfman, in his own words, "consider[ed Tome] sort of a European consultant to Seagram generally." It was in the context of the actual relationship that Bronfman conveyed to Tome a stream of material nonpublic information concerning Seagram's acquisition plans. Tome seized and actively solicited and nurtured this confidentiality, frequently probing into the internal reasons for Seagram's actions, asking Bronfman "why?" Bronfman, on the other hand, states that he sought Tome's insight into "how the European investment community would look at Seagram if [it] made such an acquisition." Unquestionably, Tome was Bronfman's friend and advisor, had formal contractual relationships with Seagram, through Finvest Geneva, and had vast experience in the securities industry;[11] clearly, Tome was looked upon and treated by Bronfman as an insider of Seagram, as he had become.

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[11] Apparently, Tome was not as open with his other associates, to whom he only selectively revealed his activities and experience and only when it behooved him to do so. For example, although Bronfman knew that Tome was the principal

(footnote continued)

In his personal finances as well, Bronfman trusted and confided in Tome. Bronfman opened a personal account with Finvest Geneva for trading in commodity futures and currencies; he gave Tome a power of attorney and discretion over his personal account. Bronfman consulted with Tome "as an advisor [for] general business purposes." This advisory function led to a "joint venture" between Bronfman and Tome, on behalf of NICO, as investors in the Broadway musical "Sophisticated Ladies." In fact, Bronfman even replaced with his own money a $5,000 bounced check that Tome issued to the "Sophisticated Ladies" partnership on behalf of NICO. On another occasion, Tome suggested a "joint venture" to Bronfman whereby they would buy a block of stock in the Bache securities firm.

Underlying and encouraging these confidential and business relationships, both Seagram-related and personal, between Bronfman and Tome were a pervasive series of social contacts. After initially meeting Tome on the plane trip for Bronfman's wife's birthday, Bronfman saw Tome regularly, approximately a dozen times, until April 1981 and exchanged telephone calls from time to time.

Given the brief period of time they had known each other, Bronfman's and Tome's close social contacts were extensive and significant, giving Tome the access to Bronfman and thus to Seagram that he promoted. In November 1980, Bronfman, his wife, and another couple spent a weekend with Tome in Mageve, France at Tome's ski lodge. On that same trip, Bronfman and his wife were personal guests at Tome's house in Geneva, Switzerland, at a dinner party. In December 1980, Tome visited Bronfman and his wife during hunting season at their home in Charlottesville, Virginia. Bronfman and his wife spent the Christmas and New Year's holidays in 1980-81 with Tome and his wife on a boat off Mexico.

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officer of Finvest Geneva and knew that he was affiliated with the U.S. securities firm of Baird-Patrick, the head of Baird-Patrick, the one who hired Tome, did not even know that Tome had any relationship with Finvest Geneva except as Baird-Patrick's registered agent for its Finvest Geneva account.

C. *Seagram's Acquisition Plans*

In August 1980, just after Bronfman met Tome, Seagram sold its interest in Texas Pacific Oil Company for $2.3 billion dollars. With this tremendous cash reserve, Seagram began looking at companies for purposes of finding an acquisition candidate. Seagram set up an acquisition committee, lined up a $3 billion dollar line of credit (that was available after November 1980),[12] and hired Arthur D. Little & Company to do a macro study of how the world would change in the next twenty to thirty years, and thus where the best business opportunities lay. Bronfman was "fascinated" with coal as the primary source of energy after oil in the next 20-30 years and began to look at companies that had coal assets, particularly Santa Fe, Amax, St. Joe, and Union Pacific.[13]

In late 1980, Tome requested that Seagram provide him with a general briefing on its policies, operations, and financials, and he informed Seagram's officers that he was interested in discussing with them Seagram's use of the proceeds it had obtained from the Texas Pacific Oil sale. The data was provided to him, and Bronfman spoke with Tome as a consultant to Seagram about its acquisition and hostile tender offer plans.

Sometime during the Fall of 1980, Seagram considered purchasing up to twenty percent of the outstanding shares of Texaco.[14] Bronfman testified that Seagram "proceeded and got pretty

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[12] Tome knew of this line of credit before it was generally reported to the public. By letter dated November 25, 1980, Tome indicated his awareness of Seagram's preparation for a "jumbo" borrowing of money. That Seagram was making preparation for a large borrowing was reported in the *Wall Street Journal* on December 12, 1980.

[13] Union Pacific, though, was almost immediately ruled out by Bronfman because "it's just a little too large to even contemplate [acquiring]."

[14] Promptly Texaco became the most heavily traded stock by Finvest Geneva in November and December 1980, according to Mr. Andrea Manzoni, former employee of Finvest Geneva who placed orders for securities purchases as either Tome, Del Pozzo, or Bulletti instructed him.

close to actually making a tender" for Texaco. Around December 10, 1980, Bronfman decided that Seagram would not proceed with the Texaco tender.[15]

Immediately after deciding not to proceed with the Texaco stock purchase, Bronfman (and his investment bankers and acquisition committee) "started to focus on Santa Fe Industries." In mid-December, while Tome visited Bronfman at his house in Charlottesville, Virginia during hunting season, Bronfman discussed Seagram's acquisition plans with Tome in an attempt to determine "how the European investment community would look at Seagram if [it] made such an acquisition":

> And he [Tome] asked, you know, had we gotten any closer to making any decision as to what we [Seagram] were going to do [about an acquisition] and I [Bronfman] said, yes I think we are looking very hard at Santa Fe. And we discussed it in general. *He wanted to know why.* I told him about the kind of asset play that it represented. (emphasis added).

Tome probed further, asking Bronfman "*when* do you think?" (emphasis added). Bronfman told him that it might take another couple of months, and that the investment banking firms of Goldman, Sachs, and Lazard Freres were advising Seagram on the matter.

Tome and Bronfman "didn't just discuss Santa Fe, but companies like Santa Fe."[16] The coal resource

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[15] Finvest Geneva began selling Texaco stock and options beginning December, really developing around December 11, through the next several months, according to Mr. Federico Pignatelli, former employee of Finvest Geneva who placed orders for securities as he was instructed by either Tome, Del Pozzo, or Bulletti.

[16] Finvest Geneva began buying Santa Fe stock heavily in late December 1980 and early January 1981, according to Manzoni. Except perhaps for Texaco, Santa Fe was the most heavily traded stock at Finvest Geneva during this time period.

companies that Bronfman had on his short list at the time were Santa Fe, Amax, and St. Joe.[17]

During this mid-December conversation, Bronfman did not consider it necessary to caution Tome that the information Bronfman was giving him was confidential because:

> I [Bronfman] didn't think it was necessary.... [because of Tome's] 20 years in this business. He ought to know the rules. I assume he does know the rules.... [The rules are] [t]hat basically [what I told him] was inside information[;] ... [y]es[, materially non-public information].

At a Board meeting of Seagram's parent corporation, held by telephone conference call on January 13, 1981, the Board authorized Seagram to invest up to $150 million dollars in four companies, *the identities of which were not revealed even to the Board members at that time*,[18] in connection with Seagram's possible interest in a candidate for aquisition. Seagram then immediately began purchasing fifteen million dollars worth of stock in each of the following companies: Santa Fe, Amax, St. Joe, and Kimberly Clark.[19]

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[17] After this mid-December conversation with Tome, according to Bronfman, during this period "it's possible that [Bronfman] could have mentioned the entire field [of potential acquisition candidates] that we [Seagram] were discussing with basically [the investment banking firm of] Lazard Freres."

[18] But, of course, Tome already had been told of the identities of these four companies as ones that Seagram was considering as a potential target and buying into at the rate of $15 million apiece.

The identities of these four companies were revealed to the Board at its next regularly scheduled meeting, February 4, 1981.

[19] Kimberly Clark was suggested by Bronfman's brother, who apparently was alone in his interest in that company. Bronfman never seriously considered Kimberly Clark as a takeover candidate.

On January 28, 1981, Seagram determined that it would not proceed with the potential acquisition of Santa Fe.[20] Bronfman conveyed this information to Tome by February 6 at the latest. That decision precipitated a sale of Santa Fe stock and options by Finvest Geneva.[21]

The decision not to pursue Santa Fe left only Amax and St. Joe as Seagram's potential takeover candidates. Tome was told of this whittling down of Seagram's possible targets.

Shortly thereafter, in early February, Amax was dropped by Seagram as a potential acquisition candidate. At a lunch that took place sometime on or before February 6, 1981, a partner of Lazard Freres, on behalf of Seagram, approached the Chairman of Standard Oil of California ("SoCal"), which owned 20% of Amax's stock, to ask if SoCal would be willing to sell its interest in Amax. After the Chairman of SoCal told him no, Seagram abandoned any idea of making an acquisition of Amax.

According to Bronfman, "*[a]lmost by a process of elimination, that left St. Joe.*" (emphasis added). Bronfman disclaimed a "clear" recollection of whether he told Tome of Seagram's discontinued interest in Amax: "I'm sorry, it's fuzzy."[22] Of the four possible

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[20] Finvest Geneva was selling Santa Fe stock and options from late January through mid-February 1981, according to Pignatelli.

[21] Although Bronfman remembers telling Tome of Seagram's discontinued interest in Santa Fe ("the next time I saw him [Tome], I probably, you know, probably told him we [Seagram] were not going to do the Santa Fe deal."), he is unclear of exactly when that was. It was at least "within the next two weeks..."

It must have been by February 6, at the latest, however, since Bronfman does not remember speaking to Tome from February 6 through March 9, 1981.

[22] Even if Tome did not hear of Seagram's discontinued interest in Amax from Bronfman, SoCal's (which already owned 20% of Amax) tender offer for Amax on March 6, 1981 would have informed Tome that Amax was no longer a viable target for Seagram. Thus, in any event, at least several days before Tome purchased St. Joe securities on March 10, he knew that St. Joe was Seagram's only viable, remaining takeover candidate.

targets in which Seagram had made an initial and token investment of fifteen million dollars, only St. Joe remained as a potential acquisition candidate for Seagram.

Bronfman asked Lazard Freres to find out as much information as possible about St. Joe and to come up with an evaluation. By February 25, 1981, Bronfman had decided that Seagram would go ahead with a tender offer for the acquisition of St. Joe.

One small diversion developed, but only momentarily. At the suggestion of an investment banker, to canvass the possibility of a "joint venture" arrangement with Santa Fe, Bronfman met for lunch on February 26 in Chicago with the Chairman and Chief Executive Officer of Santa Fe, John Reed. That meeting, however, was unsuccessful.

Seagram tried to keep its interest in St. Joe secret from the marketplace. The market activity in St. Joe securities from January through early March 1981 indicates that Seagram's efforts were largely successful; the value and price for St. Joe securities remained relatively flat. Indeed, Salomon Brothers & Co., a highly knowledgeable New York broker-dealer, executed sales of a vast block of up to one million St. Joe shares on behalf of an institutional client during the two weeks prior to, and including March 9, 1981, when the price range was $25 to $30 per share. Had there been any indication abroad that a hostile tender bid to take over St. Joe was expected by the market, Salomon Brothers surely would have advised their client to hold, rather than sell, such a large position.

For several months prior to early March, the average daily volume of trading in St. Joe options on the Philadelphia Exchange had been only about 254 options. By Thursday, March 5, 1981, there was no trading in the March 1981 options of St. Joe which were due to expire that month. The average daily volume of trading in St. Joe common stock on the New York Stock Exchange was approximately 50,000 shares. None of this was indicative to any market follower of an impending hostile tender offer.

D. *March 9, 1981 And Following*

On March 9, Bronfman was in Hilton Head, South Carolina. He was scheduled to leave there by private jet at 3:00 p.m. He accelerated his departure, however, and instead left Hilton Head at 1:00 p.m. to attend a meeting specially called for later in the afternoon in New York, at 5:30 p.m., with several Seagram executives, its investment bankers, and outside counsel to discuss a St. Joe tender. His bankers were concerned with insuring secrecy of the tender plans afoot by taking early action.

Upon his return to his office in New York, before the 5:30 p.m. meeting, Bronfman received a telephone call from Tome who was also in New York (since Sunday, March 8) at the time. The reason given by Tome for the telephone call was to invite Bronfman to dinner for the following evening, March 10.

Bronfman declined Tome's dinner invitation on the grounds that he "was going to be in Montreal for a directors' meeting." According to Bronfman, *Tome then asked Bronfman*, "[a]re you having a [Seagram] Board meeting in Montreal?"

Armed with his prior knowledge that St. Joe was Seagram's only remaining, viable takeover possibility and with the information he had just obtained from Bronfman in their March 9 phone conversation indicating, from the background of a search for a target, that some official action on corporate matters was imminent, and that Bronfman was on his way to a Board meeting, all signals of important business at hand, Tome decided to concentrate in one day frenzied buying of an enormous quantity of call options on St. Joe stock and of the stock itself; he also tipped others to do likewise. The circumstances were such that Tome reasonably inferred that a vote on a tender proposal was imminent. Tome's immediate conduct confirmed that he was not merely speculating on what was afoot; the extraordinary scope of his financial activities on the next morning was beyond any notion of rational, normal trading. The facts and circumstances lead to the ineluctable inference, which the Court draws, that Tome had obtained material non-public information in confidence from Seagram that it intended to make a tender offer for St. Joe.

Beginning 8:55 a.m. on March 10, Tome, from New York, feverishly placed overseas orders for St. Joe call options to be executed on the Philadelphia Exchange for the accounts of NICO, TFCO, and Finvest Panama. In addition, by 12:35 p.m., Tome had urged others, *i.e.*, clients and business associates, through overseas calls to Europe on at least fourteen separate occasions, to purchase St. Joe securities on American Exchanges.

Before the market opened on March 10, Tome called BSI three times, at 9:13 a.m., 9:26 a.m., and 9:51 a.m., speaking for 4 minutes, 11 minutes, and 3 minutes respectively. He placed the following orders for options[23] to purchase St. Joe stock on behalf of NICO, TFCO, and Finvest Panama through their trading accounts at BSI, spurring on the BSI broker "to rapidly pass the order":

Account	Quantity	Series		Limit Per Underlying St. Joe Share[24]
NICO	50	March	$25	$3.00
	200	March	$30	.75
	50	June	$25	5.00
	50	June	$30	2.50
TFCO	50	March	$25	$3.00
	200	March	$30	.75
	50	June	$25	5.00
	50	June	$30	2.50

[23] Each option gives the purchaser the right to purchase 100 shares of stock on terms provided by the option "series" purchased. The "series" indicates the time at which the option expires and the price at which it is exercisable. So, in this context, purchase of 50 March $25 options gives the purchaser the option through March 1981 to buy 5,000 St. Joe shares at $25 per share.

[24] This "limit per underlying share" is the maximum price Tome was willing to pay for the option. Since one option represents the right to purchase 100 shares at a future date for a fixed price, a limit of $3.00 per underlying share would result in a maximum price to buy the one option of 100 shares x $3.00, or $300.

Account	Quantity	Series		Limit Per Underlying St. Joe Share[24]
Finvest Panama	100	March	$25	$3.00
	400	March	$30	.75
	100	June	$25	5.00
	100	June	$30	2.50

Tome called BSI three additional times that day, at 11:07 a.m., 11:51 a.m., and 12:32 p.m., speaking for 6 minutes, 1 minute, and 1 minute respectively. During these calls, approximately two hours after his initial calls to BSI, as the market price began to strengthen from the impact of a buying spree, Tome authorized an increase in the limits on the options previously ordered:

Series		Original Limit	New Limit
March	$25	$3.00	$5.00
March	$30	.75	2.00
June	$25	5.00	7.00
June	$30	2.50	4.00

At the same time, Tome furnished BSI with a ¼ point discretion and reduced the order for March $30 call options from 800, total, to 400 contracts.

On March 10, through its account at A.G. Becker, a U.S. securities brokerage company, BSI made the following St. Joe option purchases as a result of Tome's order:

Total Quantity (NICO, TFCO and Finvest Panama)	Series		Average Option Price Per Underlying St. Joe Share
200	March	$25	$5.25
455[25]	March	$30	2.15
200	June	$25	7.23
200	June	$30	4.22

[25] Although Tome had reduced the options ordered in this series from 800 to 400, BSI actually obtained executions on 455. Tome accepted the extra 55 options BSI obtained.

These 1,055 options gave the purchaser the right to purchase a total of 105,500 shares of St. Joe common stock for prices of either $25 or $30 per share, depending on the series purchased.

Also on March 10, Tome called Finvest Geneva twice, at 10:30 a.m. and at 10:54 a.m., speaking for 8 and 12 minutes respectively. On March 10, a Finvest Geneva representative, undoubtedly at Tome's direction, placed an order through Baird-Patrick to buy 3,000 St. Joe shares of common stock on the New York Stock Exchange for Finvest Panama's account at BSI. That order was executed at $30 per share and delivery was made to BSI against payment from BSI's account at Irving Trust Company.[26]

Two thousand of the three thousand St. Joe shares of stock purchased for the account of Finvest Panama on March 10 were sold for approximately $94,000, netting an overnight profit of approximately $34,000. The remaining one thousand St. Joe shares subsequently were exchanged for 1,200 shares of Fluor Corp. The proceeds of the sale and the 1,200 shares are frozen in BSI's account at Irving.

In addition to Tome's direct purchases, his telephone calls caused and resulted in tippee transactions on a grand scale. At 8:55 a.m. on March 10, Tome called his client Banque du Rhone, a Swiss bank in Geneva, Switzerland, speaking for 17 minutes. About three hours later, at 11:58 a.m., Banque du Rhone purchased 200 St. Joe shares and 50 St. Joe call options, at a total cost of $16,750. The subsequent sale of these securities resulted in proceeds of $114,756, with a net profit of $98,006.

At 10:17 a.m. on March 10, Tome called Leati of Lombardfin S.p.A. in Milan, Italy, speaking for 5 minutes.[27] Leati admits that in this telephone call Tome told Leati "I'd buy [St. Joe]." In view of the interrelationships, that expression was the equivalent of a virtual direction.

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[26] This purchase was confirmed by telex to BSI from Finvest Geneva on March 11, 1981.

[27] Tome also called Lombardfin at 12:35 p.m. on March 10, speaking for 4 minutes.

Two minutes after hanging up on Tome's phone message, at 10:24 a.m., Leati, without first consulting his clients, began buying St. Joe securities on behalf of Lombardfin clients through their Lombardfin accounts. Before this first trade, Lombardfin S.p.A. had never traded even one single share of St. Joe securities. By the end of the day, however, Leati had purchased more than 40,000 shares for the following accounts and the positions were shortly thereafter liquidated with the profit results indicated:

Account Name	First Trade	Quantity[28]	Cost	Liquidation Proceeds
Credit Suisse				
Lausanne	10:24 a.m.	10,000 S	$294,375	$481,250
Osiris Ltd.	10:26 a.m.	500 O	168,237	835,062
Credito Svizzero Chiasso	11:45 a.m.	8,000 S	240,437	360,500
Unione di Bache Svizzere	1:00 p.m.	3,000 S	91,875	137,375
Banque Pictet	2:23 p.m.	3,000 S	90,375	138,375
Banque Privee	3:34 p.m.	5,000 S	150,625	235,812
Credito Svizzera Lugano	3:59 p.m.	9,200 S	276,850	437,200
Lombardfin Securities	No Time Stamp	2,000 S	60,750	93,875
TOTALS		40,200 S & 500 O	$1,373,524	$2,719,449

Deducting total cost from total proceeds, these transactions resulted in a profit of $1,345,925 for these accounts.

At 10:24 a.m. on March 10, about two minutes after getting off the phone with Leati at Lombardfin, Tome called Cramer, a Swiss bank in Geneva, Switzerland, and a Tome client, speaking

[28] The letter "S" designates St. Joe shares, and the letter "O" designates St. Joe call options.

for 5 minutes. *Twelve minutes* later, at 10:41 a.m., Cramer began buying St. Joe securities. It purchased 100 St. Joe call options and 1,000 St. Joe shares, at a total cost of $50,012. The subsequent sale of these securities shortly thereafter resulted in proceeds of $183,500, with a net profit of $133,488.

At 11:15 a.m. on March 10, Tome called Compagnie de Banque et d'Investissements ("CBI"), a Swiss bank in Geneva, Switzerland, a Tome client, and a partner in Tome's Finvest organization, speaking for 1 minute. Less than two hours later, at 1:00 p.m., CBI ordered 150 St. Joe call options and 1,100 St. Joe shares, at a total cost of $64,837. The subsequent sale of these securities shortly after the purchases resulted in proceeds of $234,000, with a net profit of $169,000.

As noted previously, on March 10, Tome called Finvest Geneva twice, once at 10:30 a.m., speaking for 8 minutes, and once at 10:54 a.m., speaking for 12 minutes. Shortly after each of these calls, two of Tome's clients, Banque Gutzwiller ("Gutzwiller") and Trade Development Bank ("TDB") began buying St. Joe securities.

At 10:40 a.m. on March 10, Gutzwiller ordered 2,000 St. Joe Shares, at a total cost of $59,250. The subsequent sale of these securities resulted in proceeds of $90,737, with a net profit of $31,487.

At 12:02 p.m. on March 10, TDB ordered 13,000 St. Joe shares, at a total cost of $390,750. At 6:39 a.m. on March 11, Tome called TDB, speaking for 10 minutes. Subsequently, beginning at 2:55 p.m. on March 11, TDB sold its St. Joe shares for proceeds of $597,675, with a net profit of $206,925.

What method Tome used to convey his inside information to Gutzwiller and to TDB cannot be stated with certainty. Under the circumstances and facts of this case, however, it is reasonably inferrable that Tome did convey his inside information to them. These two banks were clients that Tome brought over to Baird-Patrick, with Tome listed as representative for the accounts. Both banks began trading in St. Joe securities at exactly the same time

as the banks Tome had called directly. Both banks began trading very shortly after Tome's calls to Finvest Geneva. Gutzwiller placed its order two minutes after Tome had completed his first call to Finvest Geneva; TDB placed its order less than one half hour after Tome completed his second call to Finvest Geneva. The evidence shows that Tome called many of his other clients directly on March 10 to tell them to buy St. Joe securities. Tome called TDB directly at 6:39 a.m. on March 11, just hours before the Seagram tender offer was publicly announced. Unquestionably, Tome was in direct contact with at least TDB during this crucial interval.

Despite the uncertainty over *how* the inside information was conveyed by Tome to Gutzwiller and to TDB, it is reasonably inferrable that it *was* conveyed. Moreover, this uncertainty over *how* is largely due to Tome's refusal to testify in this action, by invoking his Fifth Amendment privilege against self-incrimination. While Tome has a right to remain silent and thereby to not inculpate himself and to avoid confrontation therewith in the criminal action, he is not entitled to profit by his silence in this civil action. Therefore, to the extent necessary, this Court is justified in drawing an adverse inference from Tome's assertion of his Fifth Amendment privilege in this civil action.[29] This Court finds that Tome conveyed the inside information that he possessed to Gutzwiller and to TDB, and that they subsequently traded and profited personally on that information. Consequently, Tome is liable to account for their profits obtained from these transactions.

When aggregated, the activities of Tome, as recited above, directly and indirectly, accounted for a significant portion of the volume of St. Joe option transactions executed on the Philadelphia Exchange on March 10:

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[29] For a discussion of the legal justification for drawing an adverse inference from Tome's assertion of his Fifth Amendment privilege in this civil action, *see* the separate memorandum on evidentiary issues raised in this case.

Series	Total St. Joe Calls Purchased On March 10	Total St. Joe Calls Purchased By Defendants March 10	Percentage of Total Calls On St. Joe Represented By Defendants' Purchases
March $25	285	200	70%
March $30	2334	705	30%
June $25	1334	200	15%
June $30	740	350	74%
June $35	463	50	11%
TOTALS	5,626	1,855	33%

In addition to options on 185,500 shares of St. Joe common stock, Tome and his satellite purchasers accounted for the purchase of at least 60,500 St. Joe shares, 10.67% of the total volume in St. Joe stock on the New York Stock Exchange on March 10.

On March 10, 1981, at 7:00 p.m., an unscheduled special meeting of the Seagram parent company Board of Directors was held in Montreal, Canada. This special meeting was called on short telephone notice according to the Board minutes. Bronfman, in common with the other directors, unaware of Tome's feverish trading activity earlier in the day, attended this special meeting.

Bronfman's deposition testimony was content to characterize this special meeting on March 10 as merely an "acceleration" of the "regularly scheduled" Board meeting, which was accelerated from March 11 in response to suggestions of the investment bankers concerned with maintaining confidentiality of the ongoing preparation of the tender offer to be voted on by the directors as well as probably dismayed at the market activity in the St. Joe stock on March 10. Bronfman's uncertain recollection was that the *decision* to accelerate was made at lunch on March 10, but there was no luncheon – if the recollection were true, thirteen of the fifteen Seagram parent company Directors, including eight of the ten outside Directors, and the substantial coterie of

investment bankers, consultants, engineers, and lawyers who showed up at the meeting, came to Montreal a day earlier than the fixed meeting date on *at most* six or seven hours notice before the meeting began. There was no testimony that pinpointed when he *first considered* accelerating the meeting, *i.e.*, whether accelerating the Board meeting was considered before or after he spoke to Tome on March 9 and turned down a dinner engagement for the evening of the special meeting.

On March 10, 1981, the parent company authorized Seagram to make its tender offer for the shares of St. Joe.

The defendants presented a witness with a view to explaining the extraordinary 50 % surge of the market price on March 10th 1981. Mr. Marc Cohen, an analyst in mining industries for the brokerage firm of Kidder, Peabody held to the dubious belief that events over many prior months caused the explosion. When questioned about what material non-public information might catalyze what occurred, he conceded that an awareness that a special meeting of the Seagram Board was about to take place would have been material, non-public information in light of the contemporaneous facts and circumstances and inferentially might account for what had happened.

On March 11, before Seagram's announcement of the St. Joe tender offer, Tome called BSI twice, at 6:23 a.m. and 6:25 a.m., speaking for 1 and 2 minutes respectively. At 8:00 a.m., BSI called Tome back. During this conversation, Tome instructed BSI to place an order for an additional 2,055 St. Joe call options *without price limit at the market*. While BSI was attempting to place this order, Tome anxiously stayed on an open telephone line to BSI for confirmation. BSI informed Tome that 2,000 call options was the floor trading limit on the Exchange. Tome then reduced his call option purchase order to 945 call options.

Again that morning, before the Seagram tender offer for St. Joe was publicly announced, Tome again placed overseas calls to two European clients. At 6:04 a.m. he called CBI, speaking for 1 minute. At 6:39 a.m. Tome called TDB, speaking for 10 minutes.

At 9:22 a.m. on March 11, the Seagram tender offer for St. Joe was publicly announced. The announcement resulted in a delay in the opening of trading for St. Joe securities. In consequence, the large call option orders Tome placed on the morning of March 11 were never executed on the Exchange.

At 10:30 a.m. on March 11, a so-called "regularly scheduled" Board meeting of the Seagram parent company was held in Montreal pursuant to a notice of meeting that had been forwarded to all Directors on February 23, 1981.

After the meeting on March 11, Bronfman returned to New York from Montreal. Through arrangement prior to March 9, 1981, between their wives, Bronfman and Tome met and went in the evening of March 11th to see the play they had invested in, "Sophisticated Ladies."

That evening, Bronfman discussed Seagram's tender offer for St. Joe with Tome. Bronfman discussed his telephone conversation with the St. Joe management, whom he had called just prior to Seagram's public announcement of the St. Joe tender to advise them of the impending offer. Bronfman discussed with Tome the price Seagram had tendered and speculated to Tome on Seagram's chance of success. In addition, Bronfman disclosed the timetable for the St. Joe tender and the behind-the-scenes arrangements for Board meeting schedule changes.

Despite Bronfman's confidences and discussions with Tome on the topic of the St. Joe tender offer that evening, Tome was eloquently silent and mentioned absolutely nothing to Bronfman about Tome's massive orders, trades, telephone calls overseas, and exhortations to others in regard to St. Joe securities.

Beginning on March 12, 1981, Tome instructed BSI immediately to liquidate and cash in the St. Joe option positions acquired on March 10. Specifically, at about 8:24 a.m., Tome called BSI, speaking for 9 minutes, and instructed it to sell all March options he had purchased for the acounts of NICO, TFCO, and Finvest Panama. At 8:43 a.m., Tome called Banque du Rhone, speaking for 6 minutes. Shortly thereafter, Banque du Rhone cashed in its purchases.

On March 12, Bronfman gave a dinner party in Tome's honor for twenty people at Bronfman's house. Once again, Bronfman talked to Tome about the Seagram tender offer for St. Joe. Again, Tome maintained total secrecy and made no mention to Bronfman about his activities in St. Joe securities in the prior two days.

On March 13, at 8:47 a.m., Tome called BSI, speaking for 11 minutes, and instructed it to sell the 50 June $25 options and 50 June $30 options he had acquired on March 10. On that same day, news of the SEC inquiry into possible insider trading on the Seagram bid for St. Joe was publicly disseminated.

Tome decided it was time to leave New York. Although he had reservations through March 18 at his hotel in New York, Tome cut short his visit to the United States and returned on March 14 to Switzerland.

On March 15, 1981, Tome, in Geneva, called BSI and requested that they rearrange the option purchases to make it appear that Finvest Panama had not purchased any of the St. Joe options. He suggested that Finvest Panama's purchases of March options be realloated to NICO and of June options be reallocated to TFCO. The ostensible reason for this falsification and switch was to "secure greater confidentiality within his organization." After a series of meetings, BSI vehemently declined to change its records of the transactions as they were effected. BSI reported to Tome that its account entries were "unalterable" and Tome's requests to change the record were rejected.

The SEC filed this suit on March 27, 1981. The SEC initially had difficulty in identifying so shortly after the trading activity the foreign nationals who made the trades, and the defendants were initially identified by category, not by name. As it became clear exactly who had engineered the St. Joe trades, their names were added by amendment to the title of the lawsuit.

BSI, the Swiss bank, and Irving Trust Company of New York, were the only defendants named in this suit on March 27, 1981. Proceeds of the illegal trading, as later described herein, were in the possession of Irving Trust, and under the control of BSI.

The accounts for which trades were made through the Lugano branch of BSI were identified only as those of "Unknown Purchasers."

As a result of the liquidation of the options transactions through BSI, approximately $1,825,000 (less commissions) was credited to BSI's account at Irving Trust Company, at the direction and on behalf of Tome, NICO, TFCO, and Finvest Panama. Of this sum, approximately $1,442,000 represented profit.

Despite the fact that Tome's name had not been mentioned in any public documents as being implicated in insider trading, on Monday, March 30, 1981, after hearing of this suit, Bronfman immediately telephoned Tome. Bronfman called Tome because he was concerned that:

> perhaps he [Tome] had done something. I wanted to make doubly sure he hadn't. Because the only person I knew in Switzerland that would have any knowledge one way or another of anything that was going on, at least for me, was Mr. Tome.

Bronfman was unable to reach Tome.

From Zurich, Switzerland, Tome returned the call by telephoning Bronfman at his apartment that same night at approximately 7:20 p.m. Tome said that he was sorry that Bronfman had called him earlier. He then told Bronfman the first of several boldfaced lies:

> You know, I've been in this business [*i.e.*, securities] for 20 years and I know what to do and what not to do. And clearly I certainly didn't do anything.... But, it's a little more complicated than that and I will see you in New York next week.

A week later, on Monday, April 6, at approximately 5:30 p.m., Tome dropped by Bronfman's apartment in New York unexpectedly. Tome lied again and told Bronfman that, in his absence from Geneva, "one of his [Tome's] people" had put through an order

for 3,000 shares of St. Joe stock but that "he [Tome] hadn't personally placed the order."[30] Bronfman asked Tome, point blank, "Were those shares in any way beneficially owned by you or members of your family?" Tome responded unequivocally, "No."

Bronfman and Tome met again the next morning, April 7, at 10:00 a.m. at Bronfman's office. Bronfman's attorney was present at that meeting. This time Tome had an attorney present, who arrived at approximately 10:20 a.m. Bronfman and his attorney made it clear to Tome and his attorney that any conversations they would have that day would be reported to the SEC.

At this meeting, Tome "reiterated that none of [the 3,000 shares of St. Joe stock purchased] had gone into his accounts" and that neither he, his wife, his children, nor any members of his family had any beneficial interest in St. Joe stock. He again said that "his clerk" had heard rumors about St. Joe and had decided, on his own to buy 3,000 shares and "put them in various accounts."

In addition, Tome asserted flatly that he had "absolutely nothing to do" with the St. Joe option purchases on March 10. In fact, in response to a question from Bronfman's lawyer concerning whether Tome had any reason to believe that the beneficial holder of the 3,000 St. Joe shares was in any way related to the beneficial holders of the St. Joe options involved in this suit, Tome said that "[n]o, he had no reason to think so." Tome disclaimed any direct or indirect beneficial interest in any option trades. He termed it a "coincidence" that on March 10th, in addition to the 3,000 shares, defendant BSI also purchased 1,055 St. Joe call options on 105,500 shares of stock for prices of either $25, $30, or $35 per share.

The canards were ultimately exploded. After the SEC's diligent investigation uncovered irrefutable evidence of Tome's involvement in the St. Joe option and stock trades, Tome's counsel conceded on the record that Tome had a beneficial interest in St.

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[30] Tome repeated a slightly different version of this lie to the head of Baird-Patrick, the U.S. brokerage firm with which Tome was associated.

Joe stock purchases.[31] At trial, Tome's counsel and the Court engaged in the following colloquy:

> Counsel: ... Tome was responsible for purchasing stock on March 10. That's not denied. There was an announcement –
>
> The Court: You mean it's not any longer denied?
>
> Counsel: It is not denied, your Honor.
>
> The Court: He falsified about that initially, didn't he?
>
> Counsel: I believe that the testimony of Bronfman indicates that he [Tome] was not candid about that fact, [J]udge.
>
> The Court: That's the understatement of the year.

On April 8, 1981, Tome called Bronfman from Geneva, Switzerland, and in a belligerent tone accused Bronfman of getting him into this "mess." Tome claimed that Bronfman's lawyers were going to protect Bronfman and leave Tome "out in the cold." When Tome continued to talk to Bronfman in this belligerent tone, Bronfman terminated the call. Fifteen minutes later, Tome called him back, this time very distraught. Tome was concerned with the possibility of going to jail because if he did "his career would be finished."[32]

Sometime thereafter, Bronfman, strangely enough, asked his wife to call Tome's wife to tell her "Don't worry. We love you.... The reason Edgar's [Bronfman] not calling you is because he's being advised not to. But he still loves you."

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[31] Tome's counsel now concedes, in the face of irrefutable proof, that Tome had a beneficial interest in the NICO account.

[32] Specifically, Tome told Bronfman that if Tome did not talk to the SEC, he could go to jail in the United States; conversely, if he did talk to the SEC, he could go to jail in Switzerland for violating Swiss secrecy laws.

E. *Leati's Disclosures*

Leati himself admits that in a telephone conversation on March 10, 1981, Tome advised him to purchase St. Joe securities. Leati states that he got the "hint" to buy St. Joe from Tome when Tome said "I'd buy [St. Joe]." Leati claims, however, that he never heard of Seagram, as a company, until the official announcement of the tender offer nor did he know of Tome's (and Finvest Geneva's) relationship with Seagram. He claims that after Tome gave him the "hint" on St. Joe, he bought the stock not because of any knowledge of an imminent Seagram tender offer but because "the volume [of trading in St. Joe stock] was increasing in the days immediately prior to the transaction." In essence, Leati would have this Court believe that although he received the "hint" to buy St. Joe from Tome, Leati engaged in some sophisticated, independent market research and analysis after speaking to Tome and before making the actual decision to purchase St. Joe securities for the accounts of Lombardfin S.p.A.'s clients. That notion is unworthy of belief.

In fact, the volume was not steadily increasing in the week and days immediately prior to Lombardfin S.p.A.'s March 10 purchases.[33] More significantly, however, Leati placed the first order for St. Joe stock, 10,000 shares, approximately *two minutes* after finishing his telephone conversation with Tome.[34] Leati could not have had time to investigate the St. Joe stock before trading. In

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[33] At trial, Kevin Fechan, the New York Stock Exchange specialist in St. Joe during this period of time testified as follows:

> The Court: ... so you had one day [Thursday, March 5] where there was a [trading] bulge and the other days generally subnormal ..., is that the story of that week [Monday, March 2 through Friday, March 6, 1981]?
>
> Witness: That's the story of that week.

[34] Tome's first call to Leati on March 10 was placed at 10:17 a.m. and lasted approximately five minutes. Leati's first trade *ever* in St. Joe securities, which he placed for the account of Credit Suisse Lausanne, was placed at 10:24 a.m.

this regard, it is highly significant that before March 10, 1981, Lombardfin S.p.A. had never traded even one single share of St. Joe stock. On March 10, 1981, however, it traded more than 40,000.

Not surprisingly, Csopey, Leati's former partner at Lombardfin S.p.A., tells a very different—and more believable—version of what caused Lombardfin S.p.A. to trade in St. Joe securities on March 10.[35] In his testimony, Leati was evasive and belligerent, often berating the attorney for asking a particular question. In sharp contrast, Csopey's testimony was careful and credible.[36]

Csopey was in charge of the Rome office of Lombardfin S.p.A.'s Italian domestic subsidiary—Leati was in charge of the Milan office—and thus was usually in Rome. On March 10, 1981, however, Csopey was in Milan to visit customers and to attend a Board meeting the next day.

While in the Milan office on March 10, Csopey and his then partner, Leati, had a private conversation in Leati's office. Leati

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[35] For a discussion of defendants' heresay objections to portions of Csopey's testimony, *see* the separate memorandum on evidentiary issues.

[36] Moreover, Leati's testimony was taken in Italy under the restrictive Letter Rogatory procedure and Csopey's in New York under the much more liberal standard applicable under the Federal Rules of Civil Procedure.

Defendants, through innuendo, have attempted to attack Csopey's credibility by hinting at certain events surrounding a 1984 struggle for control of Lombardfin S.p.A. between Leati and Csopey. In September 1985, at his deposition in this country, Csopey denied categorically making any threats to discuss the St. Joe matter with the SEC if Leati did not sell his interest in Lombardfin S.p.A. to Csopey. Rather than cross-examining Csopey specifically on this point, bringing out whatever evidence Tome's counsel had to support such an accusation, and getting Csopey's response or explanation thereto, Tome's counsel *chose* to raise the issue collaterally, through the hints and specters of witnesses not available in this Court for testimony under the Federal Rules. Those 1984 events and defendants' innuendoes do not detract from the circumstantial credibility of Csopey's recital of the events of 1981. The credibility of Csopey's main accuser, Mrs. Arbucias, is seriously impaired in the totality of the evidence submitted and her allegations are not worthy of belief.

told Csopey that Tome had called Leati from New York.[37] "Leati [] had been advised by Tome ... [t]hat Seagrams [sic] would make, in the next few days, make a tender offer for St. Joe Minerals." Leati said that, in exchange for $200,000, Tome was passing this information to Lombardfin S.p.A. for Lombardfin to take advantage of for itself and for its customers. This prospective payment to Tome was contingent upon there being a takeover and was to come not from Leati nor from Lombardfin S.p.A., but from those individuals profiting from Tome's information.

Leati discussed the reliability of Tome's information with Csopey, mentioned that Tome was a consultant to Seagram, and stated that "since Tome claimed to have a close personal relationship to Seagrams [sic], that this [information] could well be true."

Leati told Csopey that he had already bought some stock and options in St. Joe that day while Csopey was not in the office. Leati said that he had not spoken to any customers before placing trades on their behalf in St. Joe on March 10. Indeed, Csopey knew from his own experience that mobilizing so many trades in so short a period of time necessitated Leati to be acting on his own discretion, without first checking with customers.

At the end of this conversation, Leati, considering additional purchases of St. Joe securities, said to Csopey "Let's give it a try." In fact, Leati placed additional orders for St. Joe securities on March 11 before the New York Stock Exchange opened, but these orders could not be executed because the market opening in St. Joe was delayed by the Seagram tender offer announcement.

The next day, the Board meeting of Lombardfin S.p.A., and its Italian subsidiary, was interrupted by news of the Seagram tender offer for St. Joe. The discussion at the meeting then turned to St. Joe, with comments ranging from an estimate of the stock's

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[37] Like many of Csopey's other statements, this statement, which Csopey would have no reason to know except if Leati actually did tell him, is fully corroborated by independent evidence, *i.e.*, telephone records and Leati's own admission.

opening price to regulatory consequences for the prior day's trading. Leati explained to the board members, who were not intimately familiar with the mechanics of New York Stock Exchange trading, what was going on. In discussing the regulatory consequences, Leati admitted that the firm had committed a securities violation by trading on inside information but apparently downplayed the risk of being caught by remarking that Lombardfin S.p.A. had accounted for only a "small fraction" of the previous day's total trading volume. Csopey does not remember if, at that meeting, Tome was identified to the Board as the person providing the inside information. He was, at least, identified to them later.

On March 11, 1981, Leati told Csopey that Tome and Leati had exchanged telephone calls and Tome had told him that "[t]he launch of the [Seagram] takeover bid had been anticipated [*i.e.*, accelerated] due to market action."

Throughout 1981, after the SEC had instituted this lawsuit, Tome regularly visited Lombardfin's office in Milan. When he was in Milan, Csopey and Tome had discussions about this lawsuit in general, particularly how large the legal fees were for all people concerned. Subsequently, Leati told Csopey that Tome had pressed Leati for contributions to the legal fees and to a pool which would settle the case. In fact, when Lombardfin S.p.A. itself began running up substantial legal fees in connection with this case Leati told Csopey that Leati should have anticipated these legal expenses and "taken account" of them in the money given to Tome for providing the inside information.

II. INSIDER TRADING

The SEC brings this civil insider trading action, authorized by Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78u(d), seeking an injunction and other ancillary relief, including disgorgement of ill-gotten gains, against defendants based on defendants' violations of the antifraud provisions of the securities laws and regulations. Subject-matter jurisdiction is based on Sections 21(e) and 27 of the Exchange Act, 15 U.S.C. §§ 78u(e) and 78aa. For the reasons shown hereafter, the SEC is entitled to prevail.

The federal securities laws do not contain an express definition of insider trading. Instead, liability for insider trading has grown out of the antifraud provisions of the securities laws and regulations, primarily Section 10(b) and Rule 10b-5. As the Supreme Court has made clear, however, "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." *Chiarella v. United States*, 445 U.S. 222, 232, 100 S.Ct. 1108, 1116-17, 63 L.Ed.2d 348 (1980). The gravamen of an insider trading violation under these provisions is breach of a fiduciary or similar duty of trust and confidence arising from some relationship. An individual trading on inside information in breach of such a duty, without prior disclosure,[38] commits fraud within the meaning of Section 10(b) and Rule 10b-5.

The term "insider trading" actually is a misnomer, only imperfectly describing the proscribed conduct, since liability under the securities laws can extend to those who are not insiders, as that term is commonly understood (*e.g.*, directors and officers of the corporation, *see Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 10 & n.8 (2d Cir. 1983), *cert. denied sub nom., Moss v. Newman*, 465 U.S. 1025, 104 S.Ct. 1280, 79 L.Ed.2d 684) (1984)), if these "outsiders" either become "temporary insiders"[39] of the corporation by legitimately being given access to confidential corporate information solely for corporate purposes, *Dirks v. SEC*, 463 U.S. 646, 655 n.14, 103 S.Ct. 3255, 3262 n. 14, 77 L.Ed.2d 911 (1983), or become "tippees" by receiving inside information *improperly*. *Id.* at 660, 103 S.Ct. at 3264 (emphasis in original). Temporary insiders acquire independent fiduciary duties to the corporation and to its shareholders, and thus commit fraud within the meaning of Section 10(b) and Rule 10b-5 when they breach

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[38] If the insider cannot disclose because of a duty not to reveal confidences, he must abstain from trading altogether. *United States v. Chiarella*, 588 F.2d 1358, 1365 & n. 9 (2d Cir. 1978), *rev'd*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir.1968) (en banc), *cert. denied sub nom., Kline v. SEC*, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969). *See also infra* note 47.

[39] The term "temporary insider" apparently was coined in *SEC v. Lund*, 570 F.Supp. 1397, 1403 (C.D.Cal.1983).

their fiduciary or similar duty of trust and confidence. Tippees, however, have no independent ..duciary or similar duty of trust and confidence to the corporation or to its shareholders; their liability for insider trading "is derivative from that of the insider's duty." *Id.* at 659, 103 S.Ct. at 3264. If there has been no breach by an insider (*i.e.*, the "tipper") in conveying the inside information to the tippee, there can be no derivative breach by the tippee. *Id.* at 662, 103 S.Ct. at 3265. Even if there has been a breach by the tipper of his fiduciary or similar duty of trust and confidence, the tippee only commits fraud within the meaning of Section 10(b) and Rule 10b-5 if the tippee trades on that inside information when he "knows or should know" that the inside information was conveyed to him in breach of the tipper's duty. *Id.* at 660, 103 S.Ct. at 3264.

Tippers are jointly and severally liable for the profits obtained (or losses avoided) by their tippees. *See Bateman Eichler, Hill Richards, Inc. v. Berner*, — U.S. —, 105 S.Ct. 2622, 2630, 86 L.Ed.2d 215 (1985) ("A tippee trading on inside information will in many circumstances be guilty of fraud against individual shareholders, *a violation for which the tipper shares responsibility.*") (emphasis added); *Elkind v. Liggett & Myers, Inc*, 635 F.2d 156, 169 (2d Cir.1980).[40] Indeed, the Supreme Court has held that the tipper's conduct, almost invariably, is more culpable than that of the tippee. *Batemen*, 105 S.Ct. at 2630-31. Tipper liability is necessary so that a fiduciary does not attempt indirectly to do that which he may not do directly. *Dirks*, 463 U.S. at 659, 103 S.Ct. at 3264.

Before tipper and tippee liability arises under Section 10(b) and Rule 10b-5, however, there first must be a breach of the

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[40] Expanding on this reasoning, a tipper is liable for profits obtained (or losses avoided) from his tippee's trades, even if the tippee himself could not be held liable for those trades because he did not commit fraud within the meaning of Section 10(b) and Rule 10b-5, *i.e.*, if the tippee did not and should not have known that the information was conveyed in breach of the tipper's fiduciary duty, or because he was not joined as a defendant in the action. *See Texas Gulf Sulphur Co.*, 401 F.2d at 852-53 (tipper held liable for Section 10(b) and Rule 10b-5 violations based on tippees' trades even though tippees not joined as defendants). A tipper's liability is independent, not derivative, of the tippee's.

insider's fiduciary or similar duty of trust and confidence, satisfying the fraud element. "The test is whether the insider personally will benefit, directly or indirectly, from his disclosure." *Id.* at 662, 103 S.Ct. at 3265. Focusing on objective criteria, the court must find "a pecuniary gain or a reputational benefit that will translate into future earnings." *Id.* at 663, 103 S.Ct. at 3266. As examples of situations satisfying this breach requirement, the Supreme Court noted "a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter or an intention to benefit the particular recipient" and "a gift of confidential information to a trading relative or friend." *Id.* at 664, 103 S.Ct. at 3266 (emphasis in original). Determining whether the insider personally benefits from a disclosure is a question of fact. *Id.*

One relationship giving rise to a duty sufficient to support liability under Section 10(b) and Rule 10b-5 is a fiduciary or similar relationship of trust and confidence between the shareholders of the company whose stock is being traded and the individual trading. This is the relationship the Supreme Court focused on in *Chiarella* and *Dirks*. Recently, however, in actions brought by governmental agencies, the lower federal courts have been extending liability under Section 10(b) and Rule 10b-5 to other relationships, under a "misappropriation" theory.

The common-sense notion underlying the misappropriation theory is that one who misappropriates valuable information for his own benefit, in breach of a fiduciary or similar duty of trust and confidence, has surely committed fraud on the person or entity to whom that duty is owed. The prerequisite for liability under the misappropriation theory is misuse of nonpublic information in breach of a fiduciary or similar duty of trust and confidence to *some* person or entity, although that person or entity need not necessarily be a purchaser or a seller of securities.[4] *See*

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[4] Because of the judicially-created standing requirement limiting private Rule 10b-5 damage claims to purchasers or sellers of securities, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 95 S.Ct. 1917, 1926, 44 L.Ed.2d 539

(footnote continued)

Report of The Task Force On Regulation of Insider Trading (part 1): Regulation Under The Antifraud Provisions of The Securities Exchange Act of 1934, 41 Bus.Law. 223, 236 (No. 1985) [hereinafter cited as ABA Report]. Thus, under the misappropriation theory, the scope of the duty required to ground liability is no different than the one outlined by the Supreme Court in *Chiarella*, and reiterated in *Dirks*[42] the person or entity to whom that duty is owed, however, for purposes of liability under Section 10(b) and Rule 10b-5, is not limited solely to shareholders of the corporation whose stock is being traded (*i.e.*, the target company in a takeover situation) or to that corporation itself.

The Second Circuit, by a divided Court, has just held that the fraud element of a 10b-5 violation is satisfied when a defendant newspaper writer misappropriates, and then trades on (or tips others who trade on), nonpublic information on forthcoming articles to be published regarding the subject securities, in breach of a fiduciary or similar duty of trust and confidence to the newspaper. The violators did not breach a duty directly or derivatively to anyone involved in acquiring the securities. *United States v. Carpenter*, 791 F.2d 1024, 1029 (2d Cir.1986) ("the misappropriation theory more broadly proscribes the conversion by

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(1975), the extension of liability under Section 10(b) and Rule 10b-5 made possible by the misappropriation theory will be useful only for actions instituted by governmental agencies, such as the SEC under section 21 or the United States Attorney under section 32 of the Exchange Act. Prudent exercise of these governmental agencies' inherent prosecutorial discretion no doubt will limit even further the actions brought under the misappropriation theory.

[42] In *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.) (upholding the sufficiency of an indictment for insider trading on the theory that a son had misappropriated from his father confidential information concerning a forthcoming merger), *rev'd as to venue*, 773 F.2d 477 (2d Cir. 1985), after a scholarly review of the concepts of "fiduciary relationship" and "confidential relationship" as those terms have been understood in the law, *id.* at 703-18, the District Judge concluded that "[t]he repeated disclosure of secrets by the parties or by one party to the other may in the final analysis suffice to support a finding of a confidential relationship" sufficient to ground liability under Section 10(b) and Rule 10b-5. *Id.* at 717. Determining whether a confidential relationship exists is a question of fact. *Id.*

'insiders' *or others* of material non-public information in connection with the purchase or sale or securities.") (emphasis in original).

This "misappropriation" theory of liability under Section 10(b) and Rule 10b-5 first appeared in the case law in *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980), when the government urged the Court to affirm Chiarella's conviction for insider trading on the alternative basis that Chiarella, an employee of a financial printer employed by an acquiring corporation involved in a tender offer, violated Section 10(b) and Rule 10b-5 when he breached his duty of confidentiality to the acquiring corporation by acting upon information he received by virtue of his employee status. *Id.* at 235, 100 S.Ct. at 1118.

The Court held that "it need not decide whether this theory has merit for it was not submitted to the jury." *Id.* at 236, 100 S.Ct. at 1118. Four Justices, however, explicitly voiced their view that a defendant violates Section 10(b) and Rule 10b-5 when misappropriating, and then trading on (or tipping others who trade on), nonpublic information in breach of a fiduciary or similar duty of trust and confidence. *See id.* at 245, 100 S.Ct. at 1123 (Burger, C.J., dissenting) (Chiarella "misappropriated—stole to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence."); *id.* at 239, 100 S.Ct. at 1120 (Brennan, J., concurring); *id.* at 245, 100 S.Ct. at 1123 (Blackmun, J., joined by Marshall, J., dissenting). More recently, in *Bateman, Eichler, Hill Richards v. Berner*, — U.S. —, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985), seven Justices joined an opinion stating that "[w]e also have noted that a tippee may be liable [under Rule 10b-5] if he otherwise 'misappropriate[s] or illegally obtain[s] the information.' " *Id.* at 2630 n. 22 (quoting *Dirks v. SEC*, 463 U.S. 646, 665, 103 S.Ct. 3255, 3265, 77 L.Ed.2d911 (1983)). The two Justices who did not join the *Bateman* opinion (Justice Marshall did not participate and the Chief Judge concurred) were ones who in *Chiarella* had explicitly approved the misappropriation theory.

Although the Supreme Court has not yet explicitly decided the validity of the misappropriation theory of liability under Section

10(b) and Rule 10b-5, all nine current members of the Court appear to support the misappropriation theory.

Significantly, in the interim between the *Chiarella* and the *Bateman* decisions, the Congress has expressly approved the misappropriation theory as being consistent with the purposes of the antifraud provisions of the securities laws. *See Carpenter, supra*, at 1030 (finding "persuasive" the congressional intent expressed in the ITSA). In the House Committee Report accompanying the Insider Trading Sanctions Act of 1984 ("ITSA"), Pub.L. No. 98-376, 98 Stat. 1264 (codified in scattered sections of 15 U.S.C.) (there was no Senate report), the Congress, citing with approval the Second Circuit's decision in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *conviction aff'd without published opinion*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863, 104 S.Ct. 193, 78 L.ED.2d 170 (1983), which upheld the legal sufficiency of a criminal indictment under Section 10(b) and Rule 10b-5 based on the misappropriation theory, stated that:

> [I]n certain widely-publicized instances, agents of tender offerors and persons contemplating a merger or acquisition have used for personal gain information entrusted to them solely for a business purpose. Such conversion for personal gain of information lawfully obtained abuses relationships of trust and confidence and is no less reprehensible than the outright theft of nonpublic information. In other areas of the law, deceitful *misappropriation* of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, has consistently been held to be unlawful. The Congress has not sanctioned a less rigorous code of conduct under the federal securities laws.

H.Rep. No. 355, 98th Cong., 2d Sess. 4-5 (1983) [hereinafter cited as ITSA House Report], *reprinted in* 1984 U.S.Code Cong. & Ad.News 2274, 2277-78 (footnotes omitted and emphasis added). Although Congress, in the ITSA, increased the sanctions available for insider trading violations, it did not attempt to provide a definition of insider trading because – once again expressly

citing the Second Circuit's decision in *United States v. Newman*, *supra*—"[t]he Committee believes that the law with respect to insider trading is sufficiently well-developed at this time to provide adequate guidance." *Id.* at 13, *reprinted in* 1984 U.S.Code Cong. & Ad.News at 2286.

Frequently, the misappropriation theory will hold liable those persons breaching a duty of trust and confidentiality to a tender offeror. Indeed, insiders of a tender offeror, because they are often the only ones with advance knowledge of an impending hostile tender offer, are the ones most likely to trade (or tip) on nonpublic information regarding a hostile tender.

The problem of insider trading on tender offers has become particularly acute, especially in conjunction with the greater availability of option contracts. Persons with advance knowledge of a tender offer announcement have opportunities to profit substantially in a short time with little or no risk of loss. These opportunities can be greatly maximized on the options market because the value of an option contract tends to increase by a much greater percentage than the value of the underlying stock.

By enacting the ITSA, Congress has expressed its heightened concern over the growing problem of insider trading. One of the ITSA's provisions is an amendment to section 21(d) of the Exchange Act, expanding the SEC's enforcement remedies; it gives the SEC the authority to seek from anyone violating the insider trading laws a civil penalty of up to three times the amount of the profit gained (or loss avoided) by the insider trading.[43]

Against the background of this analytic framework and heightened Congressional concern, we turn to the liability of the individual defendants in this case.

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[43] Since this penalty provision was enacted after the St. Joe purchases at issue here, it is not applicable to this case. The SEC has not argued that this penalty provision should be applied retroactively.

III. LIABILITY

A. *Tome's Liability*[44]

1. *Violation of Section 10(b) and Rule 10b-5*

In order to prove its civil claim against Tome for violation of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5 (1985), the SEC must establish by a preponderance of the evidence,[45] (1) a misrepresentation, or an omission (where there is a duty to speak), or other fraudulent device; (2) in connection with the purchase or sale of any security; (3) scienter by the defendant

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[44] The "fugitive from justice" rule limits a fugitive litigant's access to the courts for proceedings, both civil and criminal, related to the criminal proceedings in which he has refused to appear. *United States v. $45,940 In United States Currency*, 739 F.2d 792, 798 (2d Cir.1984); *see also United States v. Sharpe*, 470 U.S. 675, 105 S.Ct. 1568, 1573 n. 2, 84 L.Ed.2d 605 (1985); *Molinaro v. New Jersey*, 396 U.S. 365, 90 S.Ct. 498 24 L.Ed.2d 586 (1970) (per curiam); *Conforte v. Commissioner*, 459 U.S. 1309, 1312, 103 S.Ct. 663, 664, 74 L.Ed.2d 588 (1983) (Rehnquist, J., in chambers). Since Tome's liability under the securities laws and regulations is clear, however, it is unnecessary to decide whether his "constructive flight", *see United States v. Catino*, 735 F.2d 718, 722 (2d Cir.), *cert. denied*, —U.S.—, 105 S.Ct. 180, 83 L.Ed.2d 114 (1984), from the related criminal proceeding, S 84 Cr. 534 (S.D.N.Y. filed August 7, 1984) affects his standing to defend this civil acction. *See United States v. Baccollo*, 725 F.2d 170, 172 (2d Cir.1983). This issue, however, may gain added significance on appeal since Tome then will be attempting to *invoke* the jurisdiction of the appellate court.

[45] The preponderance of the evidence standard is the proper burden of proof both in injunctive actions brought by the SEC, *see Herman & MacLean v. Huddleston*, 459 U.S. 375, 390, 103 S.Ct. 683, 691-92, 74 L.Ed.2d 548 (1983) (action by private litigants to establish fraud under Secton 10(b) of the Securities Exchange Acto f 1934); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 355, 64 S.Ct. 120, 125,88 L.Ed. 88 (1934) (action bythe SEC to establish fraud under Section 17(a) of the Securities Act of 1933); *SEC v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 102 (2d Cir.1978) (Friendly, J.), and in administrative proceedings before the SEC. *Steadman v. SEC*, 450 U.S. 91, 95, 101 S.Ct. 999, 1004, 67 L.Ed.2d 69 (1981).

In the ITSA House Report, the Committee stated that although Congress was increasing the sanctions available for insider trading violations, it did "not intend[ ] to require a higher standard of proof than the 'preponderance of the evidence' test now applicable to Commission injunctive actions." H.Rep. No. 355, 98th Cong., 2d Sess. 9 (1983), *reprinted in* 1984 U.S.Code Cong. & Ad.News 2274, 2282.

in making that misrepresentation or omission, *Aaron v. SEC*, 446 U.S. 680, 691, 100 S.Ct. 1945, 1952, 64 L.Ed.2d 611 (1980); and (4) materiality of that misrepresentation or omission. *See Angelastro v. Prudential-Bache Securities, Inc.*, 764 F.2d 939, 942 & n. 5 (3d Cir.), *cert. denied*, —U.S.—, 106 S.Ct. 267, 88 L.Ed.2d 274 (1985); *Warren v. Reserve Fund, Inc.*, 728 F.2d 741, 744 (5th Cir.1984); *SEC v. Washington County Utility District*, 676 F.2d 218, 225 (6th Cir.1982). *See generally ABA Report*, *supra*, 41 Bus.Law. at 231.[46]

a. *Misrepresentation, Omission, or Other Fraudulent Device*

Tome is liable under the misappropriation theory for the St. Joe purchases directly ordered by him for his NICO, TFCO, and Finvest Panama accounts at EBSI since he "fail[ed] to disclose material nonpublic information before trading on it and thus ma[de] 'secret profits.' "[47] *Dirks v. SEC*, 463 U.S. 646, 654, 103 S.Ct. 3255, 3261, 77 L.Ed.2d 911 (1983). He is also jointly and severally liable, with his tippees, for the St. Joe purchases of those he tipped since he improperly disclosed confidential corporate information to the tippees in breach of his fiduciary or similar duty of trust and confidence to Seagram, its shareholders, and Bronfman.

At the time he bought St. Joe securities and tipped others to do likewise, Tome was an insider of Seagram, the tender offeror. Bronfman and Seagram reposed their trust and confidence in Tome's integrity; Tome callously and willfully betrayed that trust.

For many months, Bronfman had provided Tome with detailed (and continually updated) nonpublic information concerning

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[46] Private litigants asserting a cause of action under Rule 10b-5 have the additional burden of proving (5) justifiable reliance upon the plaintiff's fraudulent device; and (6) damages resulting from the fraudulent device. In an SEC enforcement action, however, proof of these additional elements is not required.

[47] This Opinion need go no further than enforcement of the duty not to trade without disclosure to the beneficiary of the fiduciary relationship. *But see Carpenter*, *supra*, at 1034 ("because of [defendant Winan's] duty of confidentiality to the [*Wall Street*] Journal, [all] defendant[s] ... had a corollary duty, which they breached ... to abstain from trading in securities on the basis of the misappropriated information or to do so only upon making adequate disclosure *to those with whom they traded*.") (emphasis added).

Seagram's acquisition plans, solely for the confidential corporate purpose of evaluating Seagram's alternatives and gauging the European investment community's reaction to such a move.

The Supreme Court has recognized that persons, such as Tome here, given access to confidential corporate information solely for corporate purposes become temporary insiders of that corporation, thereby acquiring the same fiduciary duties to the corporation as other insiders:

> Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.... When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee.... For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Dirks, 463 U.S. at 655 n. 14, 103 S.Ct. at 3262 n. 14.

Seagram and Bronfman of course expected their confidences to Tome to be kept confidential by him. The relationship between the management of a corporation and its financial advisors and consultants regarding prospective hostile tender offers is inherently one which implies a duty of confidentiality. Seagram and Bronfman certainly had such an expectation of confidentiality. As soon as Bronfman learned of this lawsuit and suspected that Tome's duty of confidentiality had been breached, Bronfman called Tome in Switzerland "to make doubly sure" Tome had not been involved in the illegal St. Joe purchases alleged in the SEC's complaint. Tome, on his part, explicitly acknowledged

his obligation to keep the information he received confidential when he lied to Bronfman about trading on the inside information he had. Had there been no expectation of confidentiality, there would have been no need for Tome to lie about his trading (and tipping) in St. Joe securities when Bronfman specifically questioned him.

Tome breached his fiduciary or similar duty of trust and confidence by trading for his own behalf in the St. Joe options purchased for his NICO, TFCO, and Finvest Panama accounts at BSI. He also breached his duty by tipping others, expecting in exchange both money (the $200,000 he demanded Leati obtain from the benefitting customers of Lombardfin S.p.A.) and reputational benefits as a securities broker, that no doubt subsequently would result in increased business for him and his company, Finvest Geneva.

Tome, therefore, traded and tipped on the confidential inside information he received from Seagram and Bronfman about St. Joe, in breach of his fiduciary duty to Seagram, its shareholders, and Bronfman. He thereby committed fraud within the meaning of Section 10(b) and Rule 10b-5 by misappropriating valuable corporate information for his own benefit.

b. *In Connection With*

This requirement is easily satisfied since "[t]he information [Tome] stole ha[d] no value whatsoever except 'in connection with' his subsequent purchase of securities." *SEC v. Materia*, 745 F.2d 197, 203 (2d Cir.1984), *cert. deneid*, —U.S.—, 105 S.Ct. 2112, 85 L.Ed.2d 477 (1985). The sole purpose of Tome's theft of confidential information regarding Seagram's tender offer plans "was to reap instant no-risk profits in the stock market." *Id.; see Newman*, 664 F.2d at 18.

c. *Scienter*

Although reckless deception satisfies the scienter requirement, *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566, 575 (2d Cir.), *cert. denied*, 459 U.S. 838, 103 S.Ct. 86, 74 L.Ed.2d 80 (1982); *IIT*

v. Cornfeld, 619 F.2d 909, 923 (2d Cir.1980),[48] there is abundant evidence that Tome acted knowingly and intentionally in connection with his fraudulent activity. His frantic trading and tipping on March 10th and 11th, together with his eloquent silence concerning his frantic trading in St. Joe options when meeting Bronfman socially on the evening of March 11th—even though Bronfman was discussing with Tome the intimate details of the just-completed Seagram tender offer for St. Joe—and his subsequent lies when questioned specifically whether he had a beneficial interest in any St. Joe trades, all lead inescapably to the conclusion that Tome acted knowingly and intentionally in connection with his fraudulent activity. *See Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 167 (2d Cir.1980) ("One who deliberately tips information which he knows to be material and non-public to an outsider who may reasonably be expected to use it to his advantage has the requisite scienter.") (footnotes omitted).

d. *Materiality*

Tome clearly was in possession of material, nonpublic information when he breached his fiduciary or similar duty of trust and confidence to Seagram, its shareholders, and Bronfman by trading (and tipping). Information is material if there is a "substantial likelihood" that the information would be significant to a "reasonable investor" in making his or her investment decisions. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976) (defining materiality under proxy regulation Rule 14a-9); *Elkind*, 635 F.2d at 166 (applying the *TSC* standard to an action under Section 10(b) and Rule 10b-5, holding it to be "a relevant question in determining materiality ... whether the ... information ... would have been likely to affect the decision of potential buyers and sellers.").

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[48] The Supreme Court has not yet decided whether reckless deception satisfies the scienter requirement under Section 10(b) and Rule 10b-5. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 n. 12, 96 S.Ct. 1375, 1381 n. 12, 47 L.Ed.2d 668 (1976). Since *Hochfelder*, however, ten different courts of appeals have either held or assumed that reckless deception is sufficient. *See ABA Report*, *supra*, 41 Bus.Law. at 241 n. 70 (collecting cases).

Through the myriad disclosures by Bronfman to Tome concerning Seagram's confidential tender offer plans and potential targets, and the information concerning the Seagram parent company's Montreal Board meeting, Tome knew that Seagram's tender offer for St. Joe was imminent. Knowledge of an impending tender offer that has not previously been announced publicly is clearly material information. *SEC v. Geon Industries, Inc.*, 531 F.2d 39, 47-48 (2d Cir.1976) (holding knowledge of a proposed merger to be material information in the context of an insider trading case). The significance of this information to investors is highlighted by the temporary halting of trading in St. Joe securities and by the virtually immediate jump in price of St. Joe stock from approximately $30 per share to approximately $45 per share when the Seagram tender offer was publicly announced on March 11. *See Elkind*, 635 F.2d at 166 (reaction of investors to the information is an indication of its materiality).

2. *Violation of Section 14(e) and Rule 14e-3*

The SEC argues that Tome (and the other defendants) also violated Secton 14(e) and Rule 14e-3, 15 U.S.C. § 78n(e) and 17 C.F.R. § 240.14e-3, and that unlike a violation of Section 10(b) and Rule 10b-5, a violation of Rule 14e-3 does not require the SEC to prove scienter. *See Caleb & Co. v. E.I. DuPont de Nemours & Co.*, 599 F.Supp. 1468, 1472-73 (S.D.N.Y.1984) (holding that a violation of Rule 14e-1(c) does not require proof of scienter); *Caleb & Co. v. E.I. DuPont de Nemours & Co.*, 615 F.Supp. 96, 99 (S.D.N.Y.1985) (same, expressly citing *Schreiber*, at 101); *cf. Schreiber v. Burlington Northern, Inc.*, —U.S.—, 105 S.Ct. 2458, 2464 n. 11, 86 L.Ed.2d 1 (1985) (stating that the SEC has "latitude to regulate nondeceptive activities" under Section 14(e)). *But cf. id.* at 2646 (stating that Section 14(e) is "modeled on the antifraud provisions" of Secton 10(b) and Rule 10b-5). Since scienter is clearly present in this case, and since defendants' liability is clear under Section 10(b) and Rule 10b-5, it is unnecessary also to decide that defendants could be held liable without proof of scienter under Secton 14(e) and Rule 14e-3. *See Materia*, 745 F.2d at 203 n. 5.

B. *The Panamanian Defendants' Liability*

The Panamanian defendants, NICO, TFCO, and Finvest Panama, in a joint post-trial memorandum with Tome, concede that "[t]here is no question but that Tome directed and controlled the transactions at issue as agent of the Panamanian corporations, and consequently, whatever information Tome utilized in causing the Panamanian defendants to engage in these transactions may properly be imputed to them." Defendants' (Tome, NICO, TFCO, Finvest Panama) Post-Trial Memorandum, at 53.

We need not decide whether secondary liability can be imposed in this case upon the Panamanian defendants as controlling persons under Secton 20(a), 15 U.S.C. § 78t(a),[49] since it is clear that common law agency concepts apply to violations of Section 10(b) and Rule 10b-5. *Armstrong v. McAlpin*, 699 F.2d 79, 92 (2d Cir.1983); *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 812 (2d Cir.1975); *but cf. id.* at 813 ("We need not decide today whether the entire corpus of agency law is to be imported into the securities acts for all purposes."). Indeed, "since a corporation can act only through its agents," *id.* at 812, a corporation is liable, as a principal, for the actions of its responsible officers and authorized agents. *A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir.), *cert. denied*, 434 U.S. 969, 98 S.Ct. 516, 54 L.Ed.2d 457 (1977); *Verrechhia v. Paine, Webber, Jackson & Curtis*, 563 F.Supp. 360, 364-65 (D.P.R.1982). Since, as defendants concede, Tome had actual authority to purchase the St. Joe options at issue here, under general agency principles,the Panamanian defendants are equally liable for Tome's violations of Secton 10(b) and Rule 10b-5.

C. *Leati and Lombardfin S.p.A.'s Liability*

Although defendants Tome, NICO, TFCO, and Finvest Panama, through counsel, have appeared in this action, Leati,

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[49] In order to establish secondary liability under Section 20(a), three elements must be proved: "(1) a primary violation, (2) scienter, and (3) control of the primary violator by the defendant." *Index Fund, Inc. v. Hagopian*, 609 F.Supp. 499, 511 (S.D.N.Y.1985).

Lombardfin S.p.A., and the Unknown Purchasers have not appeared.

Originally, when this suit was filed in March 1981, the SEC was not then able to determine exactly who had engaged in the trades complained of, only that the trades had taken place. To an extent, particularly with the Unknown Purchases, because of foreign secrecy laws, that problem still exists. When the SEC was able to determine exactly who was behind the trades, it amended the title of the suit, adding those additional defendants who had previously only been identified by category (*i.e.*, as "Unknown Purchasers"). At trial, on October 23, 1985, this Court, by default, granted plaintiff SEC's motion to amend the title of the lawsuit to add Leati and Lombardfin S.p.A. as defendants. Leati's testimony was taken in Italy in October 1985 pursuant to the Letter Rogatory procedure. Before then, the testimony of Csopey, which incriminates Leati as an active participant in this illegal trading activity, had been taken in New York in September 1985. Leati and Lombardfin S.p.A., therefore, clearly were aware of the pendency of this litigation but chose not to participate in it. In addition, after this suit was filed, in May 1982 the SEC effected personal service on all defendants pursuant to Rule 4, Federal Rules of Civil Procedure, by publication of a Summons with Notice of the pendency of this suit in newspapers of general circulation in Europe, including the *International Herald Tribune*. Leati read the *International Herald Tribune* in 1981.

Leati, as Tome's tippee, committed fraud within the meaning of Section 10(b) and Rule 10b-5 because, as the testimony of Csopey (admissible against Leati as a party admission) makes clear, Leati knew or should have known that Tome's disclosures to him were made in breach of Tome's fiduciary or similar duty of trust and confidence to Seagram, its shareholders, and Bronfman. *Dirks*, 463 U.S. at 660, 103 S.Ct. at 3264. Leati was a participant after the fact in Tome's fraudulent breach. *Id.* at 667, 103 S.Ct. at 3268; *Chiarella*, 445 U.S. at 230, 100 S.Ct. at 1115 n. 12. For the same reasons as were stated when discussing Tome's liability, the fraud was "in connection with" Leati's purchase of St. Joe securities and the information was clearly material. Finally, Csopey's testimony makes it clear beyond peradventure of

doubt that Leati had the requisite scienter, *i.e.*, that he intentionally and knowingly participated in this fraudulent scheme to trade on inside information. Although it appears that Leati did in fact have a beneficial interest in at least some of the accounts for which he purchased St. Joe securities, he need not necessarily have had a beneficial interest in the accounts in order to be held liable under these antifraud provisions. If in fact any personal benefit is necessary to hold tippees liable under Section 10(b) and Rule 10b-5,[50] the commissions and reputational benefits Leati expected to enjoy from this fraudulent scheme clearly suffice. Leati is liable to account for the illegal St. Joe trades in which he engaged.

Leati is Lombardfin S.p.A.'s founder, majority stockholder, vice-chairman of the Board of Directors, and general manager. In addition to an agency theory of liability, discussed previously in relation to the Panamanian defendants, the SEC urges that Lombardfin S.p.A. is liable for Leati's Section 10(b) and Rule 10b-5 violations under the doctrine of *respondeat superior*. *See Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir.) (holding the doctrine applicable to a 10b-5 claim against a broker trainee who had held himself out as a broker and had accounted to his employer for all buying and selling transactions in which he had engaged), *cert. denied sub nom., Wood Walker & Co. v. Marbury Management Inc.*, 449 U.S. 1011, 101 S.Ct. 566, 66 L.Ed.2d 469 (1980); *Moss v. Morgan Stanley Inc.*, 553 F.Supp. 1347, 1356-57 (S.D.N.Y.) (holding the doctrine inapplicable to an insider trading case since the unauthorized trading was not within the scope of employment), *aff'd*, 719 F.2d 5 (2d Cir.1983), *cert. denied sub nom. Moss v. Newman*, 465 U.S. 1025, 104 S.Ct. 1280, 79 L.Ed.2d 684 (1984); *O'Connor*, 529 F.Supp. at 1194 (same).

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[50] Since tippees are liable as participants after the fact in the insider's breach of his fiduciary or similar duty of trust and confidence – which breach requires some personal gain to the insider – and are therefore not required to have independently breached some duty, it is not clear that tippees must personally benefit from their trades or subsequent tips to others to be held liable under Section 10(b) and Rule 10b-5 (*e.g.*, a tippee who does not trade but who merely tips another who trades), although it appears likely that in a majority of cases some personal benefit to the tippee will be present.

But because of Leati's prominent position in Lombardfin S.p.A., it is not necessary to rely on the doctrine of *respondeat superior* to hold Lombardfin S.p.A. liable. In the context of a Rule 10b-5 claim, the Third Circuit appositely held that:

> high ranking officers in a corporation, or partners in a partnership, present a different situation from lower level employees. Officers are able to make policy and generally carry authority to bind the corporation. Their action in behalf of the corporation is therefore primary, and holding a corporation liable for their actions does not require respondeat superior.

Sharp v. Coopers & Lybrand, 649 F.2d 175, 182 n. 8 (3d Cir.1981), *cert. denied*, 455 U.S. 938, 102 S.Ct. 1427, 71 L.Ed.2d 648 (1982). Because of Leati's violations of Section 10(b) and Rule 10b-5, Lombardfin S.p.A. is jointly liable for Leati's trading in St. Joe securities.

D. *BSI's Liability*

Two million dollars and 1,200 shares of Fluor Corporation stock, plus dividends, are frozen in BSI's account at Irving Trust Company, in the City of New York, pursuant to this Court's previous orders. Shortly before Seagram announced a tender offer for St. Joe Mineral stock, BSI bought 1,055 call option contracts on the Philadelphia, Pennsylvania options market for its bank customers through an American stockbroker to acquire shares of St. Joe Minerals and purchased 3,000 shares of such stock. Shortly thereafter, it ordered the liquidation of the the call options for $1,849,843.13, and the liquidation of 2,000 of the 3,000 shares for $92,739.35. The proceeds wound up in the BSI account at Irving Trust Company, and were there when this Court froze the account on application of the SEC.

BSI balances at the Irving Trust Company at the close of business on March 27, 1981 consisted of cash deposits of not less than $4,900,000, and United States marketable securities of a then-market value of not less than $326,000,000. Irving Trust Company appeared before the Court and conceded that it was in the

position of a stakeholder of the proceeds of the trades in St. Joe Minerals. BSI appeared before the Court and stated its consent to an order providing for the temporary security in the amount of two million dollars *to cover* proceeds with respect to the questioned transactions, and thereupon requested the release of the balance of the BSI bank account. That consent and security "to cover" the avails of the trading was renewed from time to time, and continues to exist right down to date.

Efforts to disclose the alleged anonymous customers of the bank were thwarted for a substantial period, but ultimately it was established that the Panamanian defendants referred to above were the purchasers and sellers of the calls and the stock. BSI was represented before the Court in this action, its counsel stating, as early as June 12, 1981, "However, with respect to the $2 million which we are prepared to consent to, we are clearly in that regard willing to allow this court *in rem* jurisdiction to the extent of that $2 million. We have no difficulty in that regard." On the representation of BSI, it seemed to the Court that the amount frozen in the New York account seemed to be adequate "to cover" the liability asserted against the then-Unknown Purchasers, later identified as the Panamanian defendants.

During the course of the litigation, it was represented to the Court that Swiss authorities had frozen funds of Unknown Purchasers at its Lugano branch. Whether the Unknown Purchasers were only the Panamanian defendants, or purchasers in addition thereto, is not clear. To avoid any juggling of the accountability for the improper trading of the Panamanian defendants as between the Lugano branch and the frozen account of BSI in New York, the Court ordered the New York branch of BSI to request that any proceeds of St. Joe trading attributable to the Panamanian companies and frozen in the Lugano offices be transferred to the New York branch, and thereafter be paid into Court to be included in the avails, subject to the disgorgement directed hereafter.

Double-payment of the avails of the trading is not intended; only that BSI be required to turn over to the plaintiff two million

dollars "to cover" the proceeds for which the Panamanian defendants are accountable under the findings in this decision. Additionally, BSI is ordered to pay the 1,200 shares of Fluor Corporation, together with dividends accumulated thereon since March 1981, proceeds from the illegal St. Joe trades held by Irving Trust Company, into the Court forthwith. Until these events have occurred, the freeze on the two million dollars in BSI's account at Irving Trust Company remains in effect. The next section of this decision deals with Unknown Purchasers other than the Panamanian defendants.

E. *Unknown Purchasers*

The Court has been informed that the Government of Switzerland has frozen at least some Unknown Purchasers' accounts containing funds relating to the illegal St. Joe transactions discussed herein. The Court dismisses, and does not adjudicate, the claims of the SEC against the Unknown Purchasers, without prejudice to any subsequent action by the SEC to determine the identities of the Unknown Purchasers or to attempt to collect the Unknown Purchasers' profits from their unlawful St. Joe purchases. Additionally, the claims of the SEC not adjudicated herein are severed and discontinued, without prejudice, to the extent that it subsequently may be discovered that Tome, Leati, Lombardfin S.p.A., or the Panamanian defendants have a further beneficial interest in any funds or accounts of the Unknown Purchasers frozen by the Swiss Government or frozen in BSI's Lugano office or located in Guernsey.

F. *Remedies*

1. *Disgorgement*

Defendants Tome, NICO, TFCO, and Finvest Panama contend that even if they are found to have violated the securities laws and regulations, disgorgement of ill-gotten gains is an inappropriate remedy in actions brought under the misappropriation theory. These defendants argue that since private plaintiffs themselves could not sue to recover these defendants' illegal profits (because of judicially-created standing requirements for a private

cause of action under Rule 10b-5, *see supra* note 41), allowing the SEC to do so would constitute an unauthorized "penalty." In essence, these defendants argue that although they were caught violating the law and reaping millions of dollars in illegal profits in so doing, once caught they need not account to anyone for these illegal profits. Neither existing case law nor policy considerations supports such an inequitable result.

In a Second Circuit decision on the misappropriation theory, the court affirmed the district court's order of disgorgement of ill-gotten gains, noting that "[d]isgorgement of illegally obtained profits is by no means a new addition to this category of permissible equitable remedies [under Section 21(d)]." *Materia*, 745 F.2d at 201. And Congress, in enacting the enhanced penalties for insider trading under the ITSA, has recently underscored the importance of the disgorgement remedy in SEC injunctive actions:

> The principal, and often effectively [the] only, remedy available to the Commission against insider trading is an injunction against further violations of the securities laws and disgorgement of illicit profits.

ITSA House Report, *supra*, at 7, *reprinted in* 1984 U.S. Code Cong. & Ad.News at 2280. In enacting these increased sanctions, Congress expressed its belief that disgorgement of illegal profits was insufficient to deter insider trading:

> Disgorgement of illegal profits has been criticized as an insufficient deterrent, because it merely restores a defendant to his original position without extracting a real penalty for his illegal behavior. The risk of incurring such penalties often fails to outweigh the temptation to convert nonpublic information into enormous profits.

Id. at 7-8, *reprinted in* 1984 U.S. Code Cong. & Ad.News at 2280-81. If the Congress believes that even full disgorgement of profits is an insufficient deterrent to insider trading, *a fortiori* less than full disgorgement, or as the defendants argue, none, is even more ineffectual. Long ago, in the first court of appeals

decision ordering disgorgement in an SEC enforcement action, the Second Circuit recognized that those who trade on inside information are simply after quick, no-risk profits, and therefore that the most effective means to deter such behavior is to make the activity unprofitable. *Texas Gulf Sulphur*, 446 F.2d at 1308 ("It would severely defeat the purposes of the [Exchange] Act if a violator of Rule 10b-5 were allowed to retain the profits from his violation."); *see also CFTC v. British American Commodity Options Corp.*, 788 F.2d 92, 94 (2d Cir. 1986) ("disgorgement serves the purpose of depriving the wrongdoer of his ill-gotten gains and deterring violations of law."); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104 (2d Cir.1972) ("The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable.").

At bottom, the defendants' arguments rest on the proposition that the SEC stands in the shoes of private litigants in bringing this injunctive proceeding. Such an assertion, however, was affirmatively rejected in *SEC v. Petrofunds, Inc.*, 420 F.Supp. 958, 960 (S.D.N.Y.1976):

> [There is a] critical distinction between actions brought by the SEC and actions brought by private litigants. Regardless of the fact that defendants may be required to disgorge profits, the SEC in no way stands in the shoes of a private litigant with respect to its claims for ancillary relief.

See also Management Dynamics, 515 F.2d at 808 ("the SEC appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws."). Disgorgement, therefore, is an appropriate, indeed an essential, remedy in an SEC enforcement action based on a misappropriation theory of insider trading liability.

The defendants found liable herein shall account for and disgorge all profits and dividends received or credited, plus interest at the average prime rate from March 11, 1981 to the date of this Opinion, from any purchases of St. Joe stock or options

between February and March 11, 1981. Defendant Tome is liable (1) individually, for accounts in which he held any economic, beneficial, or discretionary interest, and (2) jointly and severally with his tippees, the Panamanian defendants (NICO, TFCO, Finvest Panama), Leati, and Lombardfin S.p.A., for accounts in which those tippees, direct and secondary, held any economic, beneficial, or discretionary interest. Without limiting the scope of liability, Tome is liable for all profits and dividends plus interest, from all St. Joe stock and option purchases discussed in this Opinion. Tome's liability is joint and several with that of the Panamanian defendants for the St. Joe options purchased for the NICO, TFCO, and Finvest Panama accounts at BSI, and with Leati and Lombardfin S.p.A. for the St. Joe stock and option purchases placed by Leati or his subordinates for Lombardfin S.p.A.'s clients. These defendants are ordered to pay these amounts into the Court to be included in the amount subject to disgorgement. The decree to be submitted herein should set forth a plan for disgorgement and administration of the fund to be created, taking due account of similar plans previously utilized in like decisions.

2. *Permanent Injunction*

Once the SEC has proven a defendant's violation of the securities laws and regulations, it makes a "proper showing" for permanent injunctive relief, within the meaning of Section 21(d), by demonstrating, by a preponderance of the evidence, a "reasonable likelihood that the wrong will be repeated." *Manor Nursing Centers*, 458 F.2d at 1100-01; *see also Management Dynamics*, 515 F.2d at 807. In determining whether a permanent injunction is appropriate, a "district court is called upon to assess all those considerations of fairness that have been the traditional concern of equity courts." *Manor Nursing Centers*, 458 F.2d at 1102; *see also Management Dynamics*, 515 F.2d at 807 ("Whether the inference that the defendant is likely to repeat the wrong is properly drawn, however, depends on the totality of the circumstances . . . "); *see also SEC v. Monarch Fund*, 608 F.2d 938, 943 (2d Cir.1979); *SEC v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 99 (2d Cir.1978); *SEC v. Bausch*

& *Lomb, Inc.*, 565 F.2d 8, 18 (2d Cir.1977); *CFTC v. U.S. Metals Depositary Co.*, 468 F.Supp. 1149, 1161-62 (S.D.N.Y. 1979). The Second Circuit has provided additional guidance by enumerating specific factors the court should consider in making this determination:

> The factors which [a district judge] may consider include the likelihood of future violations, the degree of scienter involved, the sincerity of defendant's assurances against future violations, the isolated or recurrent nature of the infraction, defendant's recognition of the wrongful nature of his conduct, and the likelihood, because of defendant's professional occupation, that future violations might occur.

SEC v. Universal Major Industries Corp., 546 F.2d 1044, 1048 (2d Cir.1976), *cert. denied sub nom., Homans v. SEC*, 434 U.S. 834, 98 S.Ct. 120, 54 L.Ed.2d 95 (1977).

Applying these factors to this case, it is clear that the SEC is entitled to injunctive relief against defendants Tome, the Panamanian defendants, Leati, and Lombardfin S.p.A. and this court so orders. Tome acted intentionally in deceiving Bronfman and Seagram, abusing his position of trust and confidence, eventually lying about his activities when questioned specifically. *SEC v. Aaron*, 605 F.2d 612, 624 (2d Cir.1979) ("the [district] court's finding that appellant acted with scienter underscore[s] the need for an injunction."), *vacated on other grounds*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980). Tome not only traded for himself, but tipped others to encourage them to engage in illegal conduct. In fact, the evidence indicates that, before the St. Joe trades forming the basis of this suit, Tome had engaged in other trades on inside information confidentially disclosed by Bronfman concerning Seagram's tender offer plans. Tome has not indicated any remorse for his actions, except in being caught. He has remained outside the United States to avoid prosecution on a related criminal charge. In addition, his position as a broker and financial advisor would enable him to violate the law again.

The Panamanian defendants have not admitted their complicity in this scheme either. Tome has a beneficial interest in these

accounts, and had discretionary power over them. Finvest Panama is part of Tome's Finvest Group, his financial network. Should Tome attempt to violate the law again, it appears likely that he would attempt to use these corporate entities to do so.

Leati acted intentionally in engaging in the St. Joe trades on the basis of Tome's inside information. Indeed, there is evidence in the record that Leati previously traded on Tome's inside information. He has expressed no remorse for what he did; in fact, he has refused to appear in this action. His position as a broker and financial advisor would enable him to violate the law again.

As discussed previously, Lombardfin S.p.A. is dominated by Leati, both as owner and as manager. Csopey testified that other high-ranking officials of Lombardfin S.p.A. knew about the illegal trading shortly after its occurrence but did nothing to rectify the situation. Should Leati attempt to violate the law again, it appears likely that he would attempt to use Lombardfin S.p.A. to do so.

For these reasons, Tome, NICO, TFCO, Finvest Panama, Leati, and Lombardfin S.p.A. are permanently enjoined from violating the antifraud provisions of the United States securities laws and regulations.

The foregoing shall constitute the findings of fact and conclusions of law required under Rule 52(a), Federal Rules of Civil Procedure. A decree in separate form, without reciting the prior proceedings, *see* Rule 54, should be submitted on ten (10) days notice, within thirty (30) days hereof.

So Ordered.

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,

v.

Giuseppe B. TOME, Paolo Mario Leati, Lombardfin S.p.A., Transatlantic Financial Co., S.A., Nayarit Investments, S.A., Finvest Underwriters and Dealers Corp., Certain Purchasers of the Common Stock and Call Options for the Common Stock of St. Joe Minerals Corp., and Banca Della Svizzera Italiana, Defendants.

No. 81 Civ. 1836 (MP).

United States District Court,
S.D. New York.

June 3, 1986.

Ira Lee Sorkin, Regional Adm'r, S.E.C. by Anne C. Flannery, Robert B. Blackburn, Joseph G. Mari, Philip M. Giordano, Jennifer M. Russell, New York City, for plaintiff.

John F.X. Peloso, Daniel B. McIntyre, Sage Gray Todd & Sims, New York City, for defendant Giuseppe B. Tome.

Bruno Schachner, New York City, for defendants Transatlantic Financial Co., S.A., Nayarit Investments, S.A., Finvest Underwriters and Dealers Corp.

Chester J. Straub, David Trachtenberg, Wilkie Farr and Gallagher, New York City, for defendant Banca Della Svizzera Italiana.

MEMORANDUM

MILTON POLLACK, Senior District Judge.

Evidentiary Rulings

During the course of the non-jury trial herein, motions were presented by the parties for evidentiary rulings on which decision was reserved. The questions raised by the parties relate to the effect to be given to defendant Tome's assertion of his

Fifth Amendment privilege against self-incrimination and to the admissibility of portions of depositions and other exhibits submitted as evidence.

A. *The Effect of Tome's Assertion of His Fifth Amendment Privilege Against Self-Incrimination*

The plaintiff SEC sought to obtain responses from defendant Tome to interrogatories to be addressed to him in Switzerland. In an affidavit, Tome asserted his Fifth Amendment privilege against self-incrimination and refused to answer any interrogatories related to the transactions at issue in this case. Tome contends, however, that it is constitutionally impermissible for this Court to draw an adverse inference from that assertion of the privilege. Implicitly conceding that an adverse inference may be drawn in a civil case between private parties, Tome contends that it is constitutionally impermissible for this Court to do so in a civil case in which the government is the plaintiff or in which the defendant invoking the privilege is also a defendant in a parallel criminal proceeding. He relies upon language in a dissent in *Baxter v. Palmigiano*, 425 U.S. 308, 334, 96 S.Ct. 1551, 47 L.Ed.2d 810 (1976) (Brennan, J. dissenting) and some glancing dicta in *SEC v. Musella*, 578 F.Supp. 425, 431 (S.D.N.Y.1984). Tome's contention is contrary to the settled law. *See United States v. Segal*, 549 F.2d 1293, 1299 (9th Cir.), (*Baxter* "held that a negative, though not conclusive, inference can be drawn from the failure of a prisoner to testify . . . even though the testimony if given could lead to criminal prosecution."), *cert. denied*, 431 U.S. 919, 97 S.Ct. 2187, 53 L.Ed.2d 231 (1977).

The authorities cited below would have fully justified drawing an adverse inference against Tome from his assertion of the privilege against self-incrimination herein. In the circumstances presented, however, it is unnecessary to utilize the inference to establish liability. Even if needed to establish liability, it would have been merely one inference among a number of evidentiary factors considered by this Court in reaching its conclusions. Tome's liability herein has been established by a preponderance of the credible evidence, without regard to the adverse inference.

Baxter, supra, established that the Constitution does not prohibit drawing an adverse inference from a party's assertion of the privilege in civil cases since "silence in the face of accusation is a relevant fact. . . . [and] 'is often evidence of the most persuasive character.' " *Baxter*, 425 U.S. at 319, 96 S.Ct. at 1558 (quoting *United States ex rel. Bilokumsky v. Tod*, 263 U.S. 149, 153-54, 44 S.Ct. 54, 56, 68 L.Ed.2d 221 (1923) (Brandeis, J.)). The next year, in *Lefkowitz v. Cunningham*, 431 U.S. 801, 808 n. 5, 97 S.Ct. 2132, 2137 n. 5, 53 L.Ed.2d 1 (1977), the Supreme Court read its *Baxter* decision to mean that:

> *Baxter* did no more than permit an inference to be drawn in a civil case from a party's refusal to testify. Respondent's silence in *Baxter* was only one of a number of factors to be considered by the finder of fact in assessing a penalty, and was given no more probative value than the facts of the case warranted[.]

The Second Circuit has interpreted the *Baxter* rule to apply to witnesses as well as parties and through these witnesses, former employees of a party, against a party. *Brink's Inc. v. City of New York*, 717 F.2d 700, 708-10 (2d Cir.1983).

Subsequent to *Baxter* and *Lefkowitz, supra*, decisions by federal courts have established that an adverse inference is equally to be drawn where the government is a party to the civil proceeding. *see e.g. FTC v. Kitco of Nevada, Inc.*, 612 F.Supp. 1282, 1291 (D.Minn.1985) (adverse inference drawn in an FTC enforcement action); *United States v. Local 560, International Brotherhood of Teamsters*, 581 F.Supp. 279, 306 (D.N.J.1984) (adverse inference drawn in civil RICO case brought by the government), *rev'd as to this point on other grounds*, 780 F.2d 267, 292-93 n.32 (3d Cir.1985); *CFTC v. U.S. Metals Depositary Co.*, 468 F. Supp. 1149, 1162 & n. 56 (S.D.N.Y.1979). Particularly relevant hereto, courts have drawn an adverse inference in enforcement actions brought by the SEC. *See e.g. SEC v. Netelkos*, 592 F.Supp. 906, 917-18 (S.D.N.Y.1984); *SEC v. Musella*, 578 F.Supp. 425, 429-30 (S.D.N.Y.1984); *SEC v. Scott*, 565 F.Supp. 1513, 1533-34 (S.D.N.Y.1983), *aff'd sub nom, SEC v. Cayman Islands Reinsurance Corp.*, 734 F.2d 118 (2d Cir.1984); *SEC v. Gilbert*, 79

F.R.D. 683, 686 (S.D.N.Y.1978). In addition, federal courts have held that the pendency of related criminal proceedings is irrelevant in determining whether to draw an adverse inference, *see e.g., Diebold v. Civil Service Commission*, 611 F.2d 697, 701 (8th Cir.1979) (holding that the fact that the defendant asserting the privilege in a civil action has already been indicted "has no bearing on the constitutional issues involved"); *Roberts v. Taylor*, 540 F.2d 540, 542 (1st Cir. 1976) (stating that the *Baxter* decision does not "accord leeway" for distinctions between a situation in which criminal charges are pending and a situation in which only a *possibility* of criminal charges are involved), *cert. denied sub nom., Roberts v. Director, Department of Corrections*, 429 U.S. 1076, 97 S.Ct. 819, 50 L.Ed.2d 796 (1977), and many decisions have drawn an adverse inference when criminal charges are pending. *See e.g. Hoover v. Knight*, 678 F.2d 578, 582 & n. 1 (5th Cir.1982); *Book v. United States Postal Service*, 675 F.2d 158, 160 n.4 (8th Cir. 1982) (per curiam); *Arthurs v. Stern*, 560 F.2d 477, 478 (1st Cir.1977), *cert. denied*, 434 U.S. 1034, 98 S.Ct. 768, 54 L.Ed.2d 782 (1978); *Rhode Island v. Cardillo*, 592 F.Supp. 655, 658 (D.R.I.1984); *Marcello v. Long Island Railroad*, 465 F.Supp. 54, 61 (S.D.N.Y.1979).

The permissible adverse inference has been used, however, only for the purpose of determining the *scope* of Tome's liability, following a determination of his liability without use of that inference. It is used herein only for some of the transactions engaged in by those whom Tome tipped regarding the Seagram tender offer for St. Joe, specifically the transactions engaged in by Banque Gutzwiller and by Trade Development Bank.

B. *Objections To Testimony and Exhibits*

Except for two live witnesses testifying at trial, Marc Cohen, an analyst in mining industries for the brokerage firm of Kidder, Peabody & Co., and Kevin Feehan, the New York Stock Exchange specialist in St. Joe stock, all testimony in this case was received by deposition testimony. All parties appearing in this action stipulated that the deposition testimony would be admissible as though that person were testifying live at trial, and thus

absence from the trial poses no hearsay objection because of that absence.

The testimony of some foreign nationals, Mrs. Patricia Arbucias, Mr. Riccardo Argenziano, and defendant Leati, all officers and/or directors of defendant Lombardfin S.p.A., was taken pursuant to a special Letter Rogatory procedure. The range of questions permitted in such proceedings is much narrower than the range permitted in our deposition procedure; thus the information obtained is much less complete.

After giving the parties an opportunity to object on the grounds of competency, relevancy, or hearsay, to the receipt by the Court of any portions of any of the deposition testimony, defendant Tome, joined by defendants NICO, TFCO, and Finvest Panama, objected to three isolated statements in Bronfman's deposition and to Csopey's deposition testimony to the extent that he repeated what Leati told him that Tome had said in telephone conversations between Leati and Tome on March 10, 1981. All other possible objections to the deposition testimony are waived.

In addition, both plaintiff and defendants objected to documents offered into evidence as exhibits. The SEC's objections are overruled and all of defendants' exhibits, including those offered after the trial on October 23, 1985, are received into evidence. The defendants' objections to the SEC's exhibits are sustained in part, overruled in part as discussed below in more detail.

1. *Defendants' Hearsay Objections To Csopey's Testimony*

Defendants object to Csopey's testimony on hearsay grounds to the extent that he testified concerning what his partner Leati had told him about business telephone conversations between Tome and Leati on March 10, 1981. Csopey was an interested party in the business. The SEC asserts that this contested testimony is not hearsay since it is "a statement by a coconspirator of a party during the course and in furtherance of the conspiracy." Rule 801(d)(2)(E), Fed.R.Evid. The SEC claims that since Leati was Tome's coconspirator in the illegal St. Joe purchases, Leati's statements to Csopey are admissible against Tome since they were

made during the course of and in furtherance of the conspiracy. In the alternative, the SEC argues that even if the contested statements are hearsay, several exceptions to the hearsay rule are applicable. Since the coconspirator exclusion from hearsay, Rule 801(d)(2)(E), by itself permits receipt of the matter objected to, it is unnecessary to discuss the SEC's other grounds for admitting the contested testimony.

Although the vast majority of cases discussing the coconspirator exclusion from the hearsay rule are criminal cases, *see generally* Annot., *Admissibility of Statement By Coconspirator Under Rule 801(d)(2)(E) of Federal Rules of Evidence*, 44 A.L.R.Fed. 627 (1979) (collecting cases), it is clear that the rule is equally applicable to civil cases. Rule 1101(b), Fed.R.Evid.; *see e.g. Filco v. Amana Refrigeration, Inc.*, 709 F.2d 1257, 1267 (9th Cir.) (discussing coconspirator exclusion in a civil case), *cert. dismissed*, 464 U.S. 956, 104 S.Ct. 385, 78 L.Ed.2d 331 (1983); *Oreck Corp. v. Whirlpool Corp.*, 639 F.2d 75, 80-81 (2d Cir.1980) (same), *cert, denied*, 454 U.S. 1083, 102 S.Ct. 639, 70 L.Ed.2d 618 (1981). There is a paucity of civil cases involving the coconspirator exclusion, however, and it is not clear whether the same principles applicable to its use in the criminal area are equally applicable in the civil area. *See generally* Note, *Reconciling The Conflict Between The Coconspirator Exemption From The Hearsay Rule and The Confrontation Clause of The Sixth Amendment*, 35 Colum.L.,Rev. 1294 (1985) (discussing possible Confrontation Clause problems on the criminal side). *But see United States v. Inadi*, — U.S. —, 106 S.Ct. 1121, 89 L.Ed.2d 390 (1986) (holding that the Confrontation Clause does not require a showing that the declarant is unavailable as a condition to admission of out-of-court statements by a nontestifying coconspirator).[1] In addition, the coconspirator exemption, in

[1] The *Inadi* opinion did not purport to address another possible Confrontation Clause concern noted by commentators, *i.e.*, whether the coconspirator's statements must be shown to be independently reliable before being admitted. *Inadi*, 106 S.Ct. at 1124 n. 3 ("The reliability of the out-of-court statements is not at issue in this case.") *Compare United States v. Perez*, 702 F.2d 33, 37 (2d Cir.) (indicating that an independent reliability determination must be made

(Footnote continued)

effect, would be rendered a nullity on the civil side if courts required the same quantum of proof in civil actions that is presently applicable in criminal actions, *i.e.*, the preponderance of the evidence standard, *see United States v. Ciambrone*, 787 F.2d 799, 807 (2d Cir.1986); *United States v. Geaney*, 417 F.2d 1116, 1120 (2d Cir.1969), *cert. denied sub nom., Lynch v. United States*, 397 U.S. 1028, 90 S.Ct. 1276, 25 L.Ed.2d 539 (1970), before the conspirator's statement is admissible. Were a party to a civil action required to prove the existence of the conspiracy by a preponderance of the nonhearsay evidence before the coconspirator's statement is admissible, the coconspirator's statement would be merely corroborative evidence tending to reinforce the case already proved.[2] Perhaps this insight explains the dearth of civil cases addressing the coconspirator exclusion from the hearsay rule.

In this case, however, it is unnecessary to determine whether the predicate for admission of the coconspirator's statement is lower on the civil than on the criminal side since the SEC has proved the existence of a conspiracy by a preponderance of the independent evidence, *i.e.*, by admissible evidence other than the contested coconspirator's statements.[3] The contested testimony

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but stating that a declaration in furtherance of the conspiracy will often be sufficient to demonstrate reliability), *cert. denied*, 462 U.S. 1108, 103 S.Ct. 2457, 77 L.Ed.2d 1336 (1983) *with United States v. Aboumoussallem*, 726 F.2d 906, 910 (2d Cir.1984) ("*Even if* we were to require some indicia of reliability beyond the circumstance of a co-conspirator's making a report that futhers a conspiracy ...") (emphasis added). Whatever the eventual resolution of this Confrontation Clause concern may be for criminal cases, in a civil case, where Confrontation Clause concerns are not present, no independent reliability determination is required.

[2] This dilemma does not occur in criminal cases because of the difference in the quantam of proof necessary for conviction, *i.e.*, proof beyond a reasonable doubt, and for admission of the conconspirator's statement, *i.e.*, preponderance of the evidence.

[3] Of course, had the independent evidence of the conspiracy not met the preponderance standard, this Court could use the adverse inference drawn from Tome's assertion of his Fifth Amendment privilege as a factor to consider on the SEC's burden of proof as to the conspiracy's existence and as to the conspiracy's participants.

of Csopey merely reinforces the credibility of circumstantial evidence already sufficient to hold defendants liable.

It is not necessary to charge a conspiracy in the complaint in order to invoke the coconspirator exclusion from the hearsay rule. *United States v. Doulin*, 538 F.2d 466, 471 (2d Cir.), *cert. denied*, 429 U.S. 895, 97 S.Ct. 256, 50 L.Ed.2d 178 (1976); *see United States v. Clark*, 613 F.2d 391, 402-04 (2d Cir.1979) (even if acquitted on the conspiracy count, coconspirator's statements may be admissible on the substantive count), *cert. denied*, 449 U.S. 820, 101 S.Ct. 78, 66 L.Ed.2d 22 (1980). Charging a substantive violaton is sufficient. *United States v. Branker*, 418 F.2d 378, 380 (2d Cir.1969). When conspiracy is not charged, however, participants in the conspiracy often are referred to instead as "joint venturers," *see Clark*, at 404, or as "acting in concert," *see* 4 J. Weinstein & M. Berger, *Weinstein's Evidence* ¶ 801(d)(2)(E)[01] at 801-230 & n. 5 (1985), and that language appears to be apposite herein.

In determining whether the prosecution has proved by a preponderance of the evidence the existence of a "joint venture" and the defendants' participation in it, "pieces of evidence must be viewed not in isolation but in conjunction." *Geaney*, 417 F.2d at 1121. Further, " 'each of the episodes gain[s] color from each of the others.' " *United States v. Sliker*, 751 F.2d 477, 494 (2d Cir.1984) (quoting *United States v. Monia*, 295 F.2d 400, 401 (2d Cir.1961), *cert. denied*, 368 U.S. 953, 82 S.Ct. 395, 7 L.Ed.2d 386 (1962)), *cert. denied sub nom., Buchwald v. United States*, — U.S. —, 105 S.Ct. 1772, 84 L.Ed.2d 832 (1985).

Unquestionably, Tome and Leati were engaged in a joint venture to illegally trade on inside information concerning Seagram's unannounced bid for control of St. Joe. Without regard to the contested portions of Csopey's testimony, the evidence—particularly Bronfman's testimony, the BSI employees' affidavits, and Tome's trading activity—convincingly demonstrates that Tome misappropriated confidential non-public information regarding Seagram's acquisition plans and traded on it for his own benefit.

Tome also engaged in a joint venture with Leati to exploit this nonpublic information that Tome possessed. The personal

relationship between Tome and Leati and, consequently, the close business relationship between Finvest Geneva and Lombardfin S.p.A. provided fertile ground for this illicit conduct. Leati had known Tome for years, even before Leati went into brokerage. As detailed in the accompanying Opinion in this case, at 8-9, because of this personal relationship, Tome's Finvest Group, particularly Finvest Geneva, had close business ties to Lombardfin S.p.A.; Lombardfin S.p.A.'s two principal foreign affiliates were renting their *only* office space, if it could be called that, from Finvest Geneva; Tome regularly visited Lombardfin S.p.A.'s domestic subsidiary's offices and used its facilities to conduct his business; a 100% owned Lombardfin S.p.A. affiliate executed Eurobond trades on Finvest Geneva's behalf because Finvest Geneva did not have the capacity to clear trades; Finvest Geneva had a securities trading account with a 100% owned Lombardfin S.p.A. affiliate.

Against this backdrop of interaction and familiarity, the joint venture flowered. After his telephone conversation with Bronfman on March 9, Tome on March 10 began his frantic trading and tipping to overseas clients and associates.[4]

By the end of the day, Leati, acting on his discretionary authority, had purchased for Lombardfin S.p.A.'s clients, over 40,000 St. Joe shares, despite the fact that before March 10, 1981, Lombardfin S.p.A. had not traded even one single share of St. Joe stock. Leati's futile attempt to justify such enormous trading on a stock he had never previously traded, with Leati's trading beginning *two minutes* after speaking to Tome, by claiming that he engaged in some sort of independent analysis of the stock only adds an additional inference to the already overwhelming circumstantial evidence that Tome and Leati were engaged in an illicit joint venture to profit from the inside information Tome possessed concerning Seagram's plans to make a tender offer for St. Joe.

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[4] Tome's hotel only registered outgoing calls, and took messages if Tome was not in; no hotel records are kept of incoming calls if Tome was in to receive the call or if no message was left.

The statements Leati made to Csopey concerning the contents of Leati's conversations with Tome were made during the course of and in furtherance of the joint venture. Leati spoke to Csopey, Leati's partner in and co-founder of Lombardfin S.p.A., privately, in Leati's office, on the afternoon of March 10th, after speaking to Tome on the phone. While the outer temporal boundaries of a conspiracy's existence are often subject to debate, this conversation between Leati and Csopey took place right after this newly-formed illicit joint venture between Tome and Leati. Unquestionably, the contested statements took place during the course of the conspiracy. Leati made additional purchases of St. Joe securities for Lombardfin S.p.A.'s clients after the conversation with Csopey. Given the evidence in this case, it appears that the illicit association continued at least through the time that Tome was anticipating the recompense of $200,000 mentioned by Csopey (but denied by Leati) for the inside information Tome supplied to Leati for Lombardfin S.p.A.'s clients.

The statements Leati made to Csopey were also in furtherance of the illicit venture; they were intended to bring Leati's partner (who owned 12.5% of Lombardfin S.p.A.'s stock) up-to-date on the significant news that had occurred while Csopey was out in the field visiting clients and to solicit his partner's ratification of the prior St. Joe transactions and approval for further purchases. After recounting the discussions between himself and Tome, and discussing the possible accuracy of Tome's information in light of Tome's confidential position as a Seagram advisor, Leati suggested even further purchases of St. Joe securities, saying "Let's give it a try."

In these circumstances, Leati's disclosures to Csopey were clearly in furtherance of the illicit association between Tome and Leati.

Csopey's testimony concerning what Leati told him about conversations between Tome and Leati is therefore admissible as "a statement by a coconspirator of a party during the course and in furtherance of the conspiracy." Rule 801(d)(2)(E), Fed.R.Evid.

2. Defendants' Objections To Bronfman's Testimony

Defendants objected to three isolated statements in Bronfman's deposition on relevancy, materiality, and competency grounds. These objections are overruled. The Bronfman deposition, in its entirety, is admissible. Defendants objections are discussed below seriatim, with the underscored portion of the deposition testimony being the portion objected to:

> *Bronfman Transcript pages 14-15:*
>
> Q: Other than the two matters that you mentioned to us earlier, that is to advise on currency and to invest the 10 million dollars on behalf of Seagram, was there any other business or economic relationship between Mr. Tome and Seagram or any of its affiliates that you're aware of?
>
> A: Well, Tome is also a friend of mine, and we see each other a great deal socially and naturally we see each other socially and we talk about a lot of things in a business nature. And *I consider him sort of a European consultant to Seagram generally. It's not a formal relationship.*

Defendants object to the underscored portion of the testimony on the grounds that it is inappropriate opinion testimony by Bronfman and is inadmissible to prove that Tome was in fact a European consultant to Seagram. The relationship between Tome on the one hand and Bronfman and Seagram on the other, however, goes to the heart of this controversy. Bronfman's, and thus Seagram's, view of the employment and relationship with Tome, and the information disclosed within the parameters of that relationship, is extremely relevant and admissible to determine whether Bronfman and Seagram had an expectation that Tome would keep nonpublic information disclosed to him within the confines of the fiduciary or similar relationship confidential. *Dirks v. SEC*, 463 U.S. 646, 655 n.14, 103 S.Ct. 3255, 3262 n. 14, 77 L.Ed.2d 911 (1983). Moreover, Bronfman, as Chairman of the Board and Chief Executive Officer of Seagram, had

substantial control over the amount of confidential information disclosed to Tome. Bronfman's understanding of his (and Seagram's) relationship with Tome is therefore helpful in determining the scope of Tome's access to confidential information.

Bronfman Transcript pages 49-50

Q. In connection with this discussion, did you say in words or substance to Mr. Tome that the information you were discussing with him was confidential?

A. No. *I didn't think that was necessaary.*

Q. Because?

A. Management 20 years in this business. *He ought to know the rules. I assume he does know the rules.*

Defendants object to the underscored portions of the testimony on the grounds that Bronfman cannot testify as to the state of mind of Tome, nor as to what Tome understood his relationship with Seagram and Bronfman to be, since there is no evidence in this passage that Bronfman communicated his confidentiality concerns to Tome. This argument is a spurious one for several reasons. There is direct evidence emanating from Tome that he communicated to Bronfman his understanding that the information Bronfman confided to Tome, solely for the corporate purposes of Seagram, was to be kept confidential. After this suit was filed by the SEC, naming Unknown Purchasers in Switzerland as having engaged in these illegal St. Joe transactions, Bronfman called Tome to make sure he was not involved in the St. Joe trades. Tome responded to Bronfman's inquiry by stating:

You know, I've been in this business [*i.e.*, securities] for 20 years and I know what to do and what not to do. And clearly I certainly didn't do anything.

In addition, the relationship between the management of a corporation and its financial advisors and consultants regarding prospective hostile tender offers is inherently one which implies a

duty of confidentiality. *See Dirks*, 463 U.S. at 655 n. 14, 103 S.Ct. at 3262 n. 14. Moreover, Bronfman's (and therefore Seagram's) understanding of their relationship with Tome is of course relevant because it bears on the expectation of Seagram and Bronfman that the information confided to Tome would be kept confidential. *See id.*

> *Bronfman Transcript page 93*
>
> Q. Why did you call Mr. Tome?
>
> A. I called him because the S.E.C. had initiated this suit and *I was concerned that perhaps he had done something. I wanted to make doubly sure he hadn't. Because theonly person I knew in Switzerland that would have any knowledge one way or another of anything that was going on, at least for me, was Mr. Tome.*

Defendants object to the underscored portion of the testimony on the grounds that it is opinion testimony for which no proper foundation has been laid and that it is irrelevant to prove Tome's knowledge of Seagram's tender offer plans. These objections are overruled. The quoted passage explains Bronfman's motive for calling Tome in Switzerland as soon as Bronfman learned that the SEC had filed suit against Unknown Purchasers who purchased St. Joe securities through BSI, a Swiss Bank. It is highly relevant that Bronfman, the person calling the shots in Seagram's search for an acquisition and the person through whom Tome wangled his way into Seagram's affairs, picked up the phone after learning of the suit to ask Tome whether he had done anything improper with the information Bronfman had confided to him. Bronfman's act of telephoning Tome speaks louder than any words could.

3. Defendants' Objections To Certain SEC Exhibits

After trial, both sides submitted additional exhibits into evidence and opposing counsel for each side objected to the other's offer. The SEC's objections to defendants' exhibits are overruled

and all exhibits offered by defendants, both at and after trial, are received in evidence and have been reviewed.

The SEC submitted certain exhibits after trial to which the defendants offered only generalized objection.[5] One of the objections was that the exhibits (as was other information) were furnished after the Court sessions and while matters that were anticipated but had not been lodged with the Court were forthcoming. In response to the objection, the Court advised defendants' counsel that permission had been granted to supply the data, that exhibits 700, 907, 908, 909, and 913 bore on the issues or contained matter not reasonably controvertible and that "If you or Mr. Schachner have any *specific* objection to any *specific* portion of these enumerated exhibits, the Court will entertain them if received within five days of receipt of this letter." No specific objection was presented. These exhibits are received in evidence.

A further dispute arose as to the admissibility of certain trading records. Suffice it to say that the trading records of transactions so far as they refer to transactions in St. Joe call options or stock are received and those records referring to other stocks or transactions in other stocks or options are excluded. Such records of St. Joe items were known to defendants well in advance of trial, data therefrom was incorporated in the agreed findings of fact, and compilations thereof may be received appropriately in evidence under Rules 803(6), (8), (17), and (24), Fed.R.Evid. The remaining exhibits offered by the SEC post-trial are excluded.

So Ordered.

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[5] Exhibits 900, 901, 902, 903, 904, 905 and 906 were received in evidence without objection.

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,

v.

Giuseppe B. TOME, Paolo Mario Leati, Lombardfin S.p.A., Trasatlantic Financial Co., S.A., Nayarit Investments, S.A., Finvest Underwriters and Dealers Corp., Certain Purchasers of the Common Stock and Call Options for the Common Stock of St. Joe Minerals Corp., and Banca Della Svizzera Italiana, Defendants.

81 Civ. 1836 (MP).

United States District Court,
S.D. New York.

July 22, 1986.

MEMORANDUM ACCOMPANYING JUDGMENT

MILTON POLLACK, Senior District Judge.

Prejudgment Interest

The Findings and Opinion in this case, filed June 3, 1986, stated that prejudgment interest on the amounts subject to disgorgement in this civil insider trading action brought by the SEC, was to be calculated at the average prime rate for the period from March 11, 1986, the day after the unlawful purchase of St. Joe securities based on inside information, through the date of the Findings and Opinion. This amount turned out to be approximately 13% per annum. On further consideration, after hearing arguments of counsel, this Court amends the prior Opinion to rule that prejudgment interest shall be included in the judgment at the rate of 9% per annum for the period from March 11, 1986, through July 22, 1986, the date of the entry of final judgment. This 9% shall be included on all of the unlawful St. Joe trades discussed in the Opinion; the main defendant, Tome, is liable for prejudgment interest both on trades in which he had a beneficial interest and, jointly and severally with his tippees,

on trades in which he tipped others to trade but in which the SEC did not demonstrate that he had a beneficial interest.

"An award of pre-judgment interest in a case involving violations of the federal securities laws rests within the equitable discretion of the district court to be exercised according to considerations of fairness." *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 516 F.2d 172, 191 (2d Cir.1975) (involving Section 14(e) of the Securities Exchange Act of 1934), *rev'd on other grounds*, 430 U.S. 1, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977). *Accord Blau v. Lehman*, 368 U.S. 403, 414, 82 S.Ct. 451, 457, 7 L.Ed.2d 403 (1962) (involving insider's "short swing" profits under § 16(b) of the Securities Exchange Act of 1934); *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1014 (11th Cir.1985) (violation of Rule 10b-5); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 560 (5th Cir.1981) (violation of Rule 10b-5), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375, 103 S.Ct. 633, 74 L.Ed.2d 548 (1983); *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 173 n. 30 (2d Cir.1980) (violation of Rule 10b-5); *Wessel v. Buhler*, 437 F.2d 279, 284 (9th Cir.1971) (violation of Rule 10b-5).

Tome contends that it would be inequitable (and therefore an unlawful "penalty" in a disgorgement proceeding) to compel him to pay prejudgment interest on profits from his tippees' transactions since he did not have a beneficial or discretionary interest in those transactions. He contends that he should not have to pay prejudgment interest on money that he never received and for which he is liable only derivatively or vicariously.[1] In a Rule 10b-5

[1] The Supreme Court has held that the tipper's conduct, almost invariably, is more culpable than that of the tippee. *Bateman Eichler, Hill Richards, Inc. v. Berner*, —U.S.—, 105 S.Ct. 2622, 2630-31, 86 L.Ed.2d 215 (1985). Moreover, a tipper's liability is independent, not derivative, of the tippee's. *SEC v. Tome*, 81 Civ. 1836, slip op. at 58-59 n. 40 (S.D.N.Y. June 3, 1986). But if the tippee can be held liable as well, the tipper's liability is joint and several with that of his tippee. *Bateman*, 105 S.Ct. at 2630; *Elkind*, 635 F.2d at 169. A tippee, however, *cannot* be held liable unless the tipper is also liable. *Dirks v. SEC*, 463 U.S. 646, 662, 103 S.Ct. 3255, 3265, 77 L.Ed.2d 911 (1983). Given these propositions, it is illogical to argue, as Tome does, that a tippee's liability can be *greater* than that of the tippee, *i.e.*, that, as to the tippee's trades, the tippee can be held liable for prejudgment interest but that the tipper cannot.

case, however, the Second Circuit has held that "the fact that the defendants were not unjustly enriched does not, standing alone, make it inequitable to compel them to pay interest." *Rolf v. Blyth, Eastman Dillon & Co.*, 637 F.2d 77, 87 (2d Cir.1980).

In another insider trading case, another defendant put forth the argument Tome now asserts, claiming that its liability in damages for tippee trading should be limited because it did not benefit financially from the tippees' transactions. *Elkind v. Liggett & Myers, Inc.*, 472 F.Supp. 123, 134 (S.D.N.Y.1978), *aff'd in relevant part*, 635 F.2d 156 (2d Cir.1980).[2] In rejecting this argument and imposing liability on the defendant both for damages and for prejudgment interest based on its tippees' transactions, the district court noted that the defendant "acted in order to obtain other benefits[,]" *i.e.*, to foster goodwill between it and the financial analysts it tipped. *Id.* The Second Circuit affirmed the district court's finding of liability against the defendant based on its tippees' trades, specifically noting that "[t]he district court acted well within its discretion in awarding prejudgment interest . . . " on those transactions. *Elkind*, 635 F.2d at 169, 173 n. 80.

An award of prejudgment interest "is, in the first instance, compensatory[,]" but this "compensatory principle must be tempered by an assessment of the equities." *Norte & Co. v. Huffines*, 416 F.2d 1189, 1191 (2d Cir.1969), *cert. denied sub nom., Muscat v. Norte & Co.*, 397 U.S. 989, 90 S.Ct. 1121, 25 L.Ed.2d 396 (1970). In this case, Tome willfully violated the securities laws and thereafter attempted, through lies and deceit, to cover-up his role in the illegal activity; he has remained outside the United States to avoid prosecution on related criminal charges. In short, the equities do not weigh in his favor. *See id.* ("personal wrongdoings" of defendant should be considered in evaluating whether an

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[2] In this case, however, there is evidence that Tome did benefit financially from the tippee transactions. Tome was to be paid $200,000 for the tip to Leati, a tip that Tome *intended* Leati use for the benefit of Leati's firm's, Lombardfin S.p.A.'s customers. As to Tome's other tippees, he had a brokerage relationship with them and certainly expected to benefit financially through increased business from these clients in other transactions.

award of prejudgment interest is in accord with "fundamental fairness"); *Wessel*, 437 F.2d at 284 (remanding to district court for determination of prejudgment interest in a Rule 10b-5 case because of defendant's "flagrant use of false statements.").

In setting an appropriate prejudgment interest rate, this Court notes that the average prime rate during this period of time has been almost 13% per annum. Approximating what the return on a relatively safe investment during this time would have been, this Court sets the prejudgment interest rate at 9% per annum. *See Western Federal Corp. v. Davis*, 553 F.Supp. 818, 821 (D.Ariz.1982) (for a violation of Section 12 of the Securities Act of 1933, using a prejudgment interest rate of 14.25%, which was the consumer money market rate, as a benchmark, and adjusting downwards depending on the degree to which plaintiffs lost the use of their money), *aff'd sub nom., Western Federal Corp. v. Erickson*, 739 F.2d 1439 (9th Cir. 1984).

So Ordered.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------X

SECURITIES and EXCHANGE COMMISSION,

Plaintiff,

-against-

GIUSEPPE B. TOME, PAOLO MARIO LEATI, LOMBARD-FIN S.p.A., TRASATLANTIC FINANCIAL CO., S.A., NAYARIT INVESTMENTS, S.A., FINVEST UNDERWRITERS AND DEALERS CORP., CERTAIN PURCHASERS OF THE COMMON STOCK AND CALL OPTIONS FOR THE COMMON STOCK OF ST. JOE MINERALS CORP., AND BANCA DELLA SVIZZERA ITALIANA,

Defendants.

----------X

81 Civ. 1836 (MP)

JUDGMENT

This action came on for trial before the Court, Honorable Milton Pollack, Senior District Judge presiding, and the issues having been duly tried and a decision having been duly rendered, it is

I

ORDERED, ADJUDGED AND DECREED:

A. That the defendant Giuseppe B. Tome ("Tome") is found liable for, and plaintiff shall recover from said defendant who shall disgorge the sum of $3,476,706.00 together with prejudgment interest of 9% per annum for the period from March 11, 1981 to July 22, 1986, the date of entry of this judgment, which amounts to $1,677,677.30; for a total of $5,154,383.30.

B. That the defendant Trasatlantic Financial Co., S.A., ("Trasatlantic") is jointly and severally liable with the defendant Tome for, and plaintiff shall recover from said defendant who shall disgorge profits in the amount of $450,769.40 together with prejudgment interest of 9% per annum for the period from March 11, 1981 to July 22, 1986, the date of entry of this judgment, which amounts to $217,517.82 for a total of $668,287.22.

C. That the defendant Nayarit Investments, S.A. ("Nayarit") is jointly and severally liable with the defendant Tome for, and plaintiff shall recover from said defendant who shall disgorge profits in the amount of $723,331.00 together with prejudgment interest of 9% per annum for the period from March 11, 1981 to July 22, 1986, the date of entry of this judgment, which amounts to $349,032.22; for a total of $1,072,363.20.

D. That the defendant Finvest Underwriters and Dealers Corp. ("Finvest Panama") is jointly and severally liable with the defendant Tome for, and plaintiff shall recover from said defendant who shall disgorge profits in the amount of $273,277.00 together with prejudgment interest of 9% per annum for the period from March 11, 1981 to July 22, 1986, the date of entry of this judgment, which amounts to $131,869.25; for a total of $405,146.25; and Irving Trust Company of New York shall also sell and turn over to the registry of this Court the proceeds of 1,200 shares of Fluor Corporation stock in its possession subject to this Court's orders, plus dividends which have accrued since March 11, 1981. The said proceeds and dividends turned over shall be credited on account of the liability of Tome and Finvest Panama hereunder.

E. That the defendants Lombardfin S.p.A. ("Lombardfin") and Paolo Mario Leati ("Leati") are jointly and severally liable with the defendant Tome for, and plaintiff shall recover from said defendant who shall disgorge profits in the amount of $1,345,925.00 together with prejudgment interest of 9% per annum for the period from March 11, 1981 to July 22, 1986, the date of entry of this judgment, which amounts to $649,473.32; for a total of $1,995,368.30.

F. Any amount paid on account of any defendant other than Tome shall be credited toward the liability of Tome under subdivision A hereof.

G. BSI is liable for and shall pay into the Registry of this Court the deposit of $2,000,000 in its possession frozen pursuant to the Court's prior orders at the Irving Trust Company of New York to cover the liabilities of Trasatlantic, Nayarit and Finvest Panama, plus any interest which directly or indirectly has been credited during said deposit to the credit of BSI or any of the said defendants. BSI's maximum liability hereunder shall not exceed the aggregate liability of Trasatlantic, Nayarit and Finvest Panama on account of trading activities through BSI.

H. That this action as against Defendants Certain Purchasers of the Common Stock and Call Options for the Common Stock of St. Joe Minerals Corporation ("the Unknown Purchasers", i.e., other than Trasatlantic, Nayarit, Finvest Panama) be and hereby is dismissed without prejudice.

I. Let execution issue accordingly.

II

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants, Tome, Nayarit, Trasatlantic, Finvest Panama, Leati, Lombardin, their agents, servants, employees, attorneys-in-fact and those persons in active concert or participation with them and each of them, be and hereby are permanently enjoined and restrained from, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

(1) employing any device, scheme, or artifice to defraud;

(2) making any untrue statement of material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(3) engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security, in violation of Sections 10(b) and 14(e) of the Exchange Act, 15 U.S.C. § 78j(b) and 78n(e), to the extent their prohibitions are coextensive, and Rules 10b-5 and 14e-3, 17 C.F.R. § 240.10b-5 and 240.14e-3, promulgated pursuant to the Exchange Act, to the extent that the prohibitions of the Rules are coextensive, by, among other things:

(1) misappropriating, converting or obtaining by other illegal acts, in breach of a fiduciary duty, material nonpublic information concerning, *inter alia*, publicly traded companies or actual or proposed business combinations involving a public company; and

(2) purchasing or selling securities of such companies or causing such securities to be purchased or sold, unless within a reasonable time prior to such purchase or sale, such information and its source are publicly disclosed; or

(3) conveying or causing the conveyance of such information to persons, knowing, or having reason to know, such persons will purchase or sell or cause the purchase or sale of securities of such companies.

III

IT IS FURTHER ORDERED AND ADJUDGED that all of the foregoing amounts be paid in the following manner:

(1) the amounts to be paid shall be paid into the registry of this Court by certified check(s) drawn to the order of "Clerk, United States District Court, S.D.N.Y.", whereupon the Clerk of this Court, or the financial deputy clerk, is hereby directed to deposit check(s) in an interest-bearing account, as a time deposit, at the Manufacturers Hanover Trust Company, Branch #35, 277 Broadway, New York,

New York (the "Depository") so as to maximize the return on minimum risk investments, i.e. such sums may be invested in the higher yielding of United States Treasury Bills or Certificates of Deposit;

(2) the account shall be held by the Depository as a time deposit for an initial period of 90 days; thereafter it should be held for successive periods of 90 days, subject to any further orders of this Court;

(3) interest earned on the account shall be credited to the account and shall thereafter be treated in the same manner as principal;

(4) distribution of sums paid by the defendants pursuant to this Order shall be effected according to a plan for disgorgement and administration to be submitted by the Commission and approved by this Court and added to the foot of this decree.

IV

IT IS FURTHER ORDERED that this Court shall retain jurisdiction over this matter for all purposes.

s/ Milton Pollack
SENIOR UNITED STATES
DISTRICT JUDGE

Dated: New York, New York
July 22, 1986

JUDGMENT ENTERED:

s/ Raymond F. Burghardt
CLERK

INTERNATIONAL
Herald Tribune
Published with The New York Times and The Washington Post

STATE OF NEW YORK,)
) ss.:
City and County of New York)

SUMMONS with NOTICE

UNITED [illegible] AND CLEARING CORPORATION, PLAINTIFF, v. [illegible] TOKAI TRANSATLANTIC INVESTMENT CO. S.A., NAVARIT INVESTMENT S.A., INVEST INVESTMENTS AND CEDEDE S.A., AN UNKNOWN PURCHASERS OF THE COMMON STOCK AND CALL OPTIONS FOR THE COMMON STOCK OF [illegible] AND JOHN DOE CORPORATIONS, DEFENDANTS 81 Civ. 1034 (JMW) (EDNY)

RECEIVED
JUN [illegible]

the exact certain purchasers of St. Joe Minerals ("SJO") common stock or options to purchase SJO common stock on March 10, 1981. The above captioned action is presently pending in the United States District Court for the Southern District of New York ("S.D.N.Y.") alleging violations of 15 U.S.C. §§ 78j(b) and 78t(a) of the Securities Exchange Act of 1934, and Rules 10b-5, 17 C.F.R. §§ 240.10b-5 and 14e-3, 17 C.F.R. § 240.14e-3, promulgated thereunder. The suit, which presently seeks, *inter alia*, to prohibit the use of mails, interstate commerce or any facility of any national securities exchange in connection with securities transactions, if on March 10, 1981 you acquired or had an interest in the purchase of ...Oil common stock, March 25, ...March 30, June 25, or June 30 call option contracts through Banco Della Svizzera Italiana, stock or June 29 call option contract through Banque du Rhone, common stock through Credit Suisse Lausanne and Lombard Fin S.p.A. ("Lombard"), March 25, March 25, June 25 or June 29 call option contracts through Banque Populaire Suisse, Geneva and Lombard common stock through Credit Suisse Geneva and Lombardy common stock through Union de Banques Suisses and Lombardy common stock through Banque Pictet and Lombard, common stock through Banque Privee and Lombardy common stock through Credit Suisse Lugano and Lombard, common stock through Lombard Fin Securities and Lombard, common stock, March 30 or June 25 call option contracts through Cramer & Cie., common stock, March 25 or June 30 call option contracts through Compagnie de Banque et L'Investissement, common stock through Banque Gonzalez or common stock through Trade Development Bank, you are a Defendant in the above entitled action and you are summoned to submit an answer or enter an appearance in the action by serving notice of appearance on plaintiff's attorney by June 15, 1982. If you fail to appear, a judgement by default may be entered against you. The relief sought includes an injunction against you and each of you from violations of 15 U.S.C. §§ 78j(b) and 78t(a) of the Securities Exchange Act of 1934 and the Rules promulgated thereunder requiring disgorgement of all profits and the return of any unsold shares of common stock obtained as a result of the activities set forth in the Second Amended Complaint, loss of any licenses now held in the United States, and any other relief deemed just, equitable and appropriate by the Court.

If you are a defendant in the action, you are hereby cited to show cause before the U.S. District Court for the S.D.N.Y. at Room 1306 of the U.S. Courthouse at Foley Square, New York, New York on the 15th day of June, 1982 why a preliminary injunction should not be entered against you for violations of 15 U.S.C. §§ 78j(b) and 78t(a) of the Securities Exchange Act of 1934 and Rules promulgated thereunder.

The Court has jurisdiction over the matter pursuant to 15 U.S.C. §§ 78aa and 78u(e). This Summons was issued to you by direction pursuant to an Order of the Honorable Vivian Pollack, a Judge of the Court, said Order dated the 7th day of May, 1982 and on file with the Clerk of the Court.

SUMMONS with NOTICE

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF v. GIUSEPPE B. TOME, TRASATLANTIC FINANCIAL CO. S.A., NAYARIT INVESTMENTS S.A., FINVEST UNDERWRITERS AND DEALERS S.A. AND CERTAIN PURCHASERS OF THE COMMON STOCK AND CALL OPTIONS FOR THE COMMON STOCK OF ST. JOE MINERALS CORPORATION, DEFENDANTS 81 CIV. 1836 (MP) (SDNY)

Attention certain purchasers of St. Joe Minerals ("SJO") common stock or options to purchase SJO common stock on March 10, 1981. The above captioned action is presently pending in the United States District Court for the Southern District of New York ("S.D.N.Y.") alleging violations of 15 U.S.C. §§78j(b) and 78n(e) of the Securities Exchange Act of 1934 and, Rules 10b-5, 17 CFR §240.10b-5 and 14e-3, 17 CFR §240.14e-3, promulgated respectively thereunder, which provisions, *inter alia*, prohibit the use of material, non-public information in connection with securities transactions. If on March 10, 1981 you acquired or had an interest in the purchase of SJO: common stock, March/25, March/30, June/25 or June/30 call option contracts through Banca Della Svizzera Italiana; common stock or June/29 call option contracts through Banque du Rhone; common stock through Credit Suisse Lausanne and Lombard Fin S.p.A. ("Lombard"); March/30, March/35, June/25 or June/30 call option contracts through Osiris Ltd. and Lombard; common stock through Credito Suisse Chiasso and Lombard; common stock through Union di Banche Svizzere and Lombard; common stock through Banque Pictet and Lombard; common stock through Banque Privee and Lombard; common stock through Credito Svizzera Lugano and Lombard; common stock through Lombard Fin Securities and Lombard; common stock, March/30 or June/35 call option contracts through Cramer & Cie; common stock, March/35 or June/30 call option contracts through Compagnie de Banque et L'Investissements; common stock through Banque Gutzwiller; or common stock through Trade Development Bank, you are a Defendant in the above entitled action and you are

summoned to submit an answer or enter an appearance in the action by serving notice of appearance on plaintiff's attorney by July 15, 1982. If you fail to appear, a judgment by default may be entered against you. The relief sought includes: an injunction against you and each of you from further violations of 15 U.S.C. §§78j(b) and 78n(e) of the Securities Exchange Act of 1934 and the Rules promulgated thereunder; disgorgement of all profits and the return of any unsold shares of common stock obtained as a result of the activities set forth in the Second Amended Complaint; loss of any monies now frozen in the United States; and any other relief deemed just, equitable and appropriate by the Court.

If you are a defendant in this action, you are hereby cited to show cause before the U.S. District Court for the S.D.N.Y. in Room 1306 of the U.S. Courthouse at Foley Square, New York, New York on the 15 day of June, 1982 why a preliminary injunction should not be entered against you for violations of 15 U.S.C. §§78j(b) and 78n(e) of the Securities Exchange Act of 1934 and rules promulgated thereunder.

The Court has jurisdiction over this matter pursuant to 15 U.S.C. §§78u(r) and 78aa. This Summons with Notice is hereby served upon you by publication pursuant to an Order of the Honorable Milton Pollack, a Judge of the Court, said Order dated the 13 day of May, 1982 and on file with the Clerk of the Court.

CONVENTION ON THE SERVICE ABROAD OF JUDICIAL AND EXTRAJUDICIAL DOCUMENTS IN CIVIL OR COMMERCIAL MATTERS, ALL *done* NOV. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638

Article 1

The present Convention shall apply in all cases, in civil or commercial matters, where there is occasion to transmit a judicial or extrajudicial document for service abroad.

This Convention shall not apply where the address of the person to be served with the document is not known.

* * *

Article 15

Where a writ of summons or an equivalent document had to be transmitted abroad for the purpose of service, under the provisions of the present Convention, and the defendant has not appeared, judgment shall not be given until it is established that –

(a) the document was served by a method prescribed by the internal law of the State addressed for the service of documents in domestic actions upon persons who are within its territory, or

(b) the document was actually delivered to the defendant or to his residence by another method provided for by this Convention,

and that in either of these cases the service or the delivery was effected in sufficient time to enable the defendant to defend.

Each contracting State shall be free to declare that the judge, notwithstanding the provisions of the first paragraph of this article, may give judgment even if no certificate of service or delivery has been received, if all the following conditions are fulfilled –

(a) the document was transmitted by one of the methods provided for in this Convention,

(b) a period of time of not less than six months, considered adequate by the judge in the particular case, has elapsed since the date of the transmission of the document,

(c) no certificate of any kind has been received, even though every reasonable effort has been made to obtain it through the competent authorities of the State addressed.

Notwithstanding the provisions of the preceding paragraphs the judge may order, in case of urgency, any provisional or protective measures.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) of the Securities Exchange Act of 1934,
15 U.S.C. § 78n(e) (1982)

§ 78n

(e) Untrue statement of material fact or omission of fact with respect to tender offer

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d) (Supp. IV 1986)

§ 78u. Investigations and actions

[See main edition for text of (a) to (c)]

(d) Injunction proceedings; criminal proceedings; civil penalty actions relating to transactions when in possession of material nonpublic information; persons liable, exemptions, amount of penalty, payment into Treasury, and period of limitations

(1) Wherever[11] it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

(2)(A) Whenever it shall appear to the Commission that any person has violated any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material nonpublic information in a transaction (i) on or through the facilities of a national securities exchange or from or through a broker or dealer, and (ii) which is not part of a public offering by an issuer of securities other

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[11] So in original. Probably should be "Whenever".

than standardized options, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by such person, or any person aiding and abetting the violation of such person. The amount of such penalty shall be determined by the court in light of the facts and circumstances, but shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase or sale, and shall be payable into the Treasury of the United States. If a person upon whom such a penalty is imposed shall fail to pay such penalty within the time prescribed in the court's order, the Commission shall refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court. The actions authorized by this paragraph may be brought in addition to any other actions that the Commission or the Attorney General are entitled to bring. For purposes of section 78aa of this title, actions under this paragraph shall be actions to enforce a liability or a duty created by this chapter. The Commission, by rule or regulation, may exempt from the provisions of this paragraph any class of persons or transactions.

(B) No person shall be subject to a sanction under subparagraph (A) of this paragraph solely because that person aided and abetted a transaction covered by such subparagraph in a manner other than by communicating material nonpublic information. Section 78t(a) of this title shall not apply to an action brought under this paragraph. No person shall be liable under this paragraph solely by reason of employing another person who is liable under this paragraph.

(C) For purposes of this paragraph "profit gained" or "loss avoided" is the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable period after public dissemination of the nonpublic information.

(D) No action may be brought under this paragraph more than five years after the date of the purchase or sale. This paragraph shall not be construed to bar or limit in any manner any action by the Commission or the Attorney General under

any other provision of this chapter, nor shall it bar or limit in any manner any action to recover penalties, or to seek any other order regarding penalties, imposed in an action commenced within five years of such transaction.

[See main edition for text of (e) to (h)]

Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(e) (1982)

§ 78u. Investigations and actions

(e) Mandamus

Upon application of the Commission the district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this chapter, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, (2) any national securities exchange or registered securitiers association to enforce compliance by its members and persons associated with its members with the provisions of this chapter, the rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

Section 27 of the Securities Exchange Act of 1934m
15 U.S.C. § 78aa (1982)

§ 78aa. Jurisdiction of offenses and suits

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987)

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

SEC Rule 14e-3, 17 C.F.R. § 240.14e-3 (1987)

§240.14e-3 Transactions in securities on the basis of material, nonpublic information in the context of tender offers.

(a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) The offering person,

(2) The issuer of the securities sought or to be sought by such tender offer, or

(3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

(b) A person other than a natural person shall not violate paragraph (a) of this section if such person shows that:

(1) The individual(s) making the investment decision on behalf of such person to purchase or sell any security described in paragraph (a) of the section or to cause any such security to be purchased or sold by or on behalf of others did not know the material, nonpublic information; and

(2) Such person had implemented one or a combination of policies and procedures, reasonable under the circumstances, taking into consideration the nature of the person's business, to ensure that individual(s) making investment decision(s) would not

violate paragraph (a) of this section, which policies and procedures may include, but are not limited to, (i) those which restrict any purchase, sale and causing any purchase and sale of any such security or (ii) those which prevent such individual(s) from knowing such information.

(c) Notwithstanding anything in paragraph (a) of this section to contrary, the following transactions shall not be violations of paragraph (a) of this section:

(1) Purchase(s) of any security described in paragraph (a) of this section by a broker or by another agent on behalf of an offering person; or

(2) Sale(s) by any person of any security described in paragraph (a) of this section to the offering person.

(d)(1) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, it shall be unlawful for any person described in paragraph (d)(2) of this section to communicate material, nonpublic information relating to a tender offer to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of this section *except* that this paragraph shall not apply to a communication made in good faith.

(i) To the officers, directors, partners or employees of the offering person, to its advisors or to other persons, involved in the planning, financing, preparation or execution of such tender offer;

(ii) To the issuer whose securities are sought or to be sought by such tender offer, to its officers, directors, partners, employees or advisors or to other persons, involved in the planning, financing, preparation or execution of the activities of the issuer with respect to such tender offer; or

(iii) To any person pursuant to a requirement of any statute or rule or regulation promulgated thereunder.

(2) The persons referred to in paragraph (d)(1) of this section are:

(i) The offering person or its officers, directors, partners, employees or advisors;

(ii) The issuer of the securities sought or to be sought by such tender offer or its officers, directors, partners, employees or advisors;

(iii) Anyone acting on behalf of the persons in paragraph (d)(2)(i) of this section or the issuer or persons in paragraph (d)(2)(ii) of this section; and

(iv) Any person in possession of material information relating to a tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from any of the above.

Federal Rules of Civil Procedure
Rule 4(c)(2)(C)(i)

Rule 4. Process

(c) Service.

(2)(C) A summons and complaint may be served upon a defendant of any class referred to in paragraph (1) or (3) of subdivision (d) of this rule –

> (i) pursuant to the law of the State in which the district court is held for the service of summons or other like process upon such defendant in an action brought in the courts of general jurisdiction of that State, or

Federal Rules of Civil Procedure
Rule 4(e)

Rule 4. Process

(e) Summons: Service Upon Party Not Inhabitant of or Found Within State. Whenever a statute of the United States or an order of court thereunder provides for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state in which the district court is held, service may be made under the circumstances and in the manner prescribed by the statute or order, or, if there is no provision therein prescribing the manner of service, in a manner stated in this rule. Whenever a statute or rule of court of the state in which the district court is held provides (1) for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state, or (2) for service upon or notice to such a party to appear and respond or defend in an action by reason of the attachment or garnishment or similar seizure of the party's property located within the state, service may in either case be made under the circumstances and in the manner prescribed in the statute or rule.

Federal Rules of Civil Procedure
Rule 4(i)(1)

Rule 4. Process.

(i) ALTERNATIVE PROVISIONS FOR SERVICE IN A FOREIGN COUNTRY.

(1) Manner. When the federal or state law referred to in subdivision (e) of this rule authorizes service upon a party not an inhabitant of or found within the state in which the district court is held, and service is to be effected upon the party in a foreign country, it is also sufficient if service of the summons and complaint is made: (A) in the manner prescribed by the law of the foreign country for service in that country in an action in any of its courts of general jurisdiction; or (B) as directed by the foreign authority in response to a letter rogatory, when service in either case is reasonably calculated to give actual notice; or (C) upon an individual, by delivery to the individual personally, and upon a corporation or partnership or association, by delivery to an officer, a managing or general agent; or (D) by any form of mail, requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the party to be served; or (E) as directed by order of the court. Service under (C) or (E) above may be made by any person who is not a party and is not less than 18 years of age or who is designated by order of the district court or by the foreign court. On request, the clerk shall deliver the summons to the plaintiff for transmission to the person or the foreign court or officer who will make the service.

New York Civil Practice Law and Rules § 308
(McKinney 1972 & Supp. 1988)

§ 308. Personal service upon a natural person

Personal service upon a natural person shall be made by any of the following methods:

1. by delivering the summons within the state to the person to be served; or

2. by delivering the summons within the state to a person of suitable age and discretion at the actual place of business, dwelling place or usual place of abode of the person to be served and by either mailing the summons to the person to be served at his last known residence or by mailing the summons by first class mail to the person to be served at his actual place of business in an envelope bearing the legend "personal and confidential" and not indicating on the outside thereof, by return address or otherwise, that the communication is from an attorney or concerns an action against the person to be served; proof of such service shall be filed within twenty days thereafter with the clerk of the court designated in the summons; service shall be complete ten days after such filing; proof of service shall identify such person of suitable age and discretion and state the date, time and place of service, except in matrimonial actions where service hereunder may be made pursuant to an order made in accordance with the provisions of subdivision a of section two hundred thirty-two of the domestic relations law; or

3. by delivering the summons within the state to the agent for service of the person to be served as designated under rule 318, except in matrimonial actions where service hereunder may be made pursuant to an order made in accordance with the provisions of subdivision a of section two hundred thirty-two of the domestic relations law;

4. where service under paragraphs one and two cannot be made with due diligence, by affixing the summons to the door of either the actual place of business, dwelling place or usual place of abode within the state of the person to be served and

by either mailing the summons to such person at his last known residence or by mailing the summons by first class mail to the person to be served at his actual place of business in an envelope bearing the legend "personal and confidential" and not indicating on the outside thereof, by return address or otherwise, that the communication is from an attorney or concerns an action against the person to be served; proof of such service shall be filed within twenty days thereafter with the clerk of the court designated in the summons; service shall be complete ten days after such filing, except in matrimonial actions where service hereunder may be made pursuant to an order made in accordance with the provisions of subdivision a of section two hundred thirty-two of the domestic relations law;

5. in such manner as the court, upon motion without notice, directs, if service is impracticable under paragraphs one, two and four of this section.

New York Civil Practice Law and Rules § 314 (McKinney 1972)

§ 314. Service without the state not giving personal jurisdiction in certain actions.

Service may be made without the state by any person authorized by section 313 in the same manner as service is made within the state:

1. in a matrimonial action; or

2. where a judgment is demanded that the person to be served be excluded from a vested or contingent interest in or lien upon specific real or personal property within the state; or that such an interest or lien in favor of either party be enforced, regulated, defined or limited; or otherwise affecting the title to such property, including an action of interpleader or defensive interpleader; or

3. where a levy upon property of the person to be served has been made within the state pursuant to an order of attachment or a chattel of such person has been seized in an action to recover a chattel.

New York Civil Practice Law and Rules § 315
(McKinney 1972)

§ 315. Service by publication authorized

The court, upon motion without notice, shall order service of a summons by publication in an action described in section 314 if service cannot be made by another prescribed method with due diligence.

Supreme Court, U.S.
FILED
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CLERK

Nos. 87-1321 and 87-1368

In the Supreme Court of the United States

OCTOBER TERM, 1987

LOMBARDFIN S.p.A. AND PAOLO MARIO LEATI, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

TRASATLANTIC FINANCIAL CO., S.A., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether publication of a Summons with Notice, as ordered by the district court, is authorized by Fed. R. Civ. P. 4, and is constitutionally sufficient where petitioners received actual notice of the lawsuit but elected not to appear.

2. Whether the purchase of securities of a target corporation while in possession of material nonpublic information regarding an imminent tender offer, misappropriated from the tender offeror in breach of a fiduciary duty, constitutes conduct "in connection with the purchase or sale of * * * securit[ies]" within the meaning of the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and SEC Rule 10b-5, 17 C.F.R. 240.10b-5.

3. Whether a district court may order the disgorgement of illegal trading profits in an injunctive action brought by the Securities and Exchange Commission.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-1321

LOMBARDFIN S.p.A. AND PAOLO MARIO LEATI, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

No. 87-1368

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A24) is reported at 833 F.2d 1086.[1] The opinions of the district court (Pet. App. A25-A100) are reported at 638 F. Supp. 596, 629, and 638.

JURISDICTION

The judgment of the court of appeals was entered on November 20, 1987. The petition for a writ of certiorari in No. 87-1321 was filed on February 8, 1988, and the peti-

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[1] References to "Pet. App." are to the appendix to the petition in No. 87-1321.

tion in No. 87-1368 was filed on February 16, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

After a bench trial in the United States District Court for the Southern District of New York, petitioners were found to have violated antifraud provisions of the federal securities laws by trading in the securities of a target corporation, one day before the public announcement of a tender offer, while in possession of material nonpublic information misappropriated from the tender offeror. The district court permanently enjoined petitioners from violating Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and SEC Rule 10b-5, 17 C.F.R. 240.10b-5, and, to the extent coextensive, Section 14(e) of the Exchange Act, 15 U.S.C. 78n(e), and SEC Rule 14e-3, 17 C.F.R. 240.14e-3. Petitioners were also ordered to disgorge nearly $3 million in illegal profits. The court of appeals affirmed (Pet. App. A1-A24).

1. The evidence at trial showed that petitioners participated in an international securities trading scheme orchestrated by defendant Giuseppe Tome, an Italian securities professional residing in Switzerland who is presently a fugitive from United States justice (Pet. App. A27-A29, A81). Having actively cultivated a personal and professional relationship of trust and confidence with Joseph E. Seagram & Co. and Edgar Bronfman, Seagram's chairman and chief executive officer (*id.* at A5-A6, A26, A33-A35), Tome obtained advance knowledge that Seagram was about to make a tender offer for the stock of St. Joe Minerals Corp. (*id.* at A41). Early on the morning of March 10, 1981—one day before the public announce-

ment of the tender offer caused the price of St. Joe stock to jump from $30 to more than $45 per share (*id.* at A26)—Tome "feverishly" (*id.* at A7) placed orders from New York for the purchase in the United States of massive quantities of St. Joe securities.

In particular, acting on behalf of petitioners in No. 87-1368—Panamanian corporations that Tome owned and over which he exercised discretionary trading authority—Tome directed defendant Banca della Svizzera Italiana ("BSI") in Lugano, Switzerland, to purchase St. Joe call options (Pet. App. A31-A32).[2] Tome also placed numerous telephone calls to individuals at other Swiss banks and foreign financial institutions; immediately thereafter, each of those persons likewise purchased large amounts of St. Joe securities (*id.* at A44-A47). Tome and his tippees dominated the market in St. Joe securities the day before the tender offer, accounting for 33 percent of all St. Joe options purchased, as well as more than 10 percent of all St. Joe stock purchased on the New York Stock Exchange (*id.* at A48).

Among Tome's tippees was Paolo Mario Leati, a petitioner in No. 87-1321. Leati, an Italian national, is the manager and majority owner of co-petitioner Lombardfin, S.p.A., a brokerage firm registered with the SEC, with offices in Milan and Rome, and which shared offices with Tome's firm in Geneva. Pet. App. A5, A30-A31, A56. The evidence showed that Tome placed a telephone call to Leati on March 10 and advised him that Seagram would be making a tender offer for St. Joe "in the next few days" (*id.* at A56-A57, A73). Two minutes later, Leati, who had never before purchased St. Joe securities, bought nearly $1.4 million worth of St. Joe securities for accounts

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[2] The court of appeals concluded (Pet. App. A21) that the Panamanian corporations were Tome's alter egos.

of Lombardfin customers over which he exercised discretionary trading authority (*id.* at A45). Leati had long-standing business and social ties to Tome (*id.* at A5, A90-A91), and he immediately credited Tome's tip because he knew that Tome had a close relationship to Seagram (*id.* at A9). In return for the information, Leati agreed to pay Tome $200,000 out of his share of any profits (*id.* at A22, A56-A57). Leati subsequently admitted at a meeting of Lombardfin's board of directors that Lombardfin's St. Joe trades "obviously" violated the United States securities laws (*id.* at A22-A23).

2. On March 27, 1981, the respondent, the Securities and Exchange Commission, commenced a civil enforcement action arising out of the March 10 trading in St. Joe securities (Pet. App. A10). At that time, the Commission did not know who was responsible for the massive St. Joe purchases, since the trades had been effected through BSI, in accounts shrouded by bank secrecy laws (*id.* at A12). The Commission accordingly named as defendants in its complaint only BSI, Irving Trust Company (where BSI had deposited certain of the proceeds of the trades), and "Certain Purchasers" of St. Joe securities (*id.* at A12, A51-A52).

It was not until November 1981—after the district court had directed BSI, on penalty of contempt, to identify the principals behind the trades—that the Commission learned of the identities of Tome and the petitioning Panamanian corporations (Pet. App. A12). The Commission accordingly amended its complaint in December 1981 to include those defendants by name (*ibid.*). The Commission amended the complaint a second time on May 13, 1982, to expand the category of "certain purchasers" to include Tome's tippees (*id.* at A13)—including, more specifically, those persons who had effected St. Joe transactions through accounts at Lombardfin. Although the

Commission knew at that time that there had been illegal trading through the Lombardfin accounts, it did not know that petitioners Leati and Lombardfin were culpable, and accordingly the Commission did not identify them by name as defendants.

The Commission's failure to learn of Leati's and Lombardfin's culpability was due to the fact that those petitioners had furnished false and misleading information to the Commission in connection with its investigation of this matter (Pet. App. A12-A13). Petitioners submitted false trading records that erroneously stated that Lombardfin's St. Joe purchases were "unsolicited"—that is, effected at the request of its customers, and not at Leati's instance (*id.* at A13). Moreover, Leati provided the Commission with an affidavit in which he falsely asserted that he had not traded on the basis of nonpublic information (*id.* at A12-A13).

In light of the difficulties in ascertaining the identities of the St. Joe purchasers, the Commission moved for an order, pursuant to Fed. R. Civ. P. 4, to permit service on the unknown purchasers by publication (Pet. App. A13). The district court granted the motion, and a Summons with Notice was published once a week for four consecutive weeks, in May and June 1982, in the *International Herald Tribune*, a newspaper widely read by the international financial community in Europe (see Pet. App. A14-A15, A73).

In October 1985 the Commission learned through discovery that Leati and Lombardfin were among the unknown persons who had traded illegally in St. Joe securities. Based upon that new knowledge, the Commission, shortly before trial was scheduled to commence, sought to amend the second amended complaint to identify Leati and Lombardfin, by name, as defendants. On October 17, 1985, at the Commission's request, the district

court issued an order to show cause to that effect; a member of the Italian bar personally delivered that order to petitioners on October 18 at the Lombardfin office in Milan. Pet. App. A15. At a hearing on the motion on October 23, 1985, at which Leati and Lombardfin did not appear, the district court held that the 1982 service by publication—coupled with evidence in the record showing that Leati and Lombardfin "clearly were aware of the pendency of this litigation but chose not to participate in it"—satisfied notice and service requirements (*id.* at A73). The district court also determined that, because Leati and Lombardfin had previously been charged as unknown defendants in 1982, the substitution of their names in the complaint was not a substantive amendment that required the Commission to re-serve the complaint (*id.* at A16). Accordingly, the court ordered that the caption of the complaint be modified so as to identify Leati and Lombardfin by name as among the "Certain Purchasers" charged as defendants (*id.* at A73).

3. Following trial, the district court held that petitioners had violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder; it ordered disgorgement of petitioners' illegal profits; and it issued a permanent injunction against future violations of the antifraud provisions (Pet. App. A25-A82). The court found, first (*id.* at A69), that Tome had "traded and tipped on the confidential inside information he received from Seagram and Bronfman about St. Joe, in breach of his fiduciary duty to Seagram, its shareholders, and Bronfman." The court noted, moreover (*id.* at A72), that the Panamanian corporations were "equally liable for Tome's violations of Section 10(b) and Rule 10b-5," noting (*ibid.*) that those corporations had conceded that Tome had been acting as their agent in making the St. Joe purchases. The court also found (*id.* at A72-A75) that Leati and Lombardfin, who

did not appear in the district court, were liable as Tome's tippees. It explained (*id.* at A73) that Leati "knew or should have known that Tome's disclosures to him were made in breach of Tome's fiduciary or similar duty of trust and confidence to Seagram, its shareholders, and Bronfman." And it added (*id.* at A74) that Lombardfin was liable as well, in that Leati, the company's "founder, majority stockholder, vice-chairman of the Board of Directors, and general manager," had acted illegally and had done so as Lombardfin's agent. The court permanently enjoined petitioners from committing future violations of the antifraud provisions of the federal securities laws (*id.* at A80-A82), and it ordered them to disgorge their illegal profits and to pay prejudgment interest (*id.* at A77-A80, A101-A104).[3]

4. The court of appeals affirmed (Pet. App. A1-A24).[4] In pertinent part, the court rejected (*id.* at A12-A20) the claim, made for the first time on appeal (*id.* at A19), that the district court lacked jurisdiction over petitioners Leati and Lombardfin. The court held (*id.* at A17) that "[p]ublication * * * in the *International Herald Tribune*

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[3] Leati and Lombardfin were ordered to disgorge more than $1.3 million in illegal profits (plus nearly $650,000 in interest). The Panamanian corporations were ordered to disgorge more than $1.4 million in illegal profits (plus nearly $700,000 in interest). The district court ordered defendant BSI to pay into the registry of the court $2 million (which represented most of the Panamanian corporations' illegal profits, including interest) that had been frozen in BSI's account at Irving Trust at the outset of the case. BSI satisfied the judgment against it on November 18, 1986, and did not appeal. Pet. App. A101-A103.

[4] The court of appeals dismissed Tome's appeal on November 25, 1986, because he was (and remains) a fugitive from justice in a related criminal proceeding (Pet. App. A4 n.1). The court declined, however, to dismiss the appeal of Tome's alter ego corporations, the petitioning Panamanian corporations (*ibid.*).

was 'reasonably calculated' to notify the unidentified purchasers of St. Joe options, including Leati and Lombardfin," and thus satisfied the requirements of *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950). The court added, moreover, that there was "no doubt" that well before trial Leati and Lombardfin had known of the suit brought by the Commission and the nature of the claims against them (Pet. App. A17-A18), but that petitioners had made a "conscious decision to ignore this action until after a judgment had been rendered against them" (*id.* at A20). And the court rejected the contention (*id.* at A19) that the Commission should have used a different means of serving process on the ground that it knew petitioners' names and addresses. The court explained (*ibid.*) that "Leati's affidavit and the misleading trading records deceived the Commission into believing that they were not involved in Tome's scheme."[5] Finally, the court of appeals rejected (*id.* at A23-A24) petitioners' contention that the district court lacked the power to order the disgorgement of illegal profits. The court explained that the district court had properly exercised its equitable power to "make sure that wrongdoers will not profit from their wrongdoing" (*id.* at A24).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore unwarranted.

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[5] The Commission had moved to supplement the record on appeal to show that Leati and Lombardfin, in addition to being aware of the proceedings, had actually received in May 1982 a copy of the published Summons with Notice appearing that month in the *International Herald Tribune*. A copy of that notice had been found in Lombardfin's files in Italy. See C.A. SEC Supp. App. 16-22. Because

1. Petitioners Leati and Lombardfin contend (87-1321 Pet. 8-22) that the district court lacked personal jurisdiction over them. That claim does not warrant further review. As the court of appeals held (Pet. App. A12-A20), jurisdiction was properly exercised: the Commission secured a court order under Fed. R. Civ. P. 4 to proceed by publication abroad, and that method of service was "reasonably calculated" to apprise petitioners of the pendency of the action and to afford them, had they wished it, an opportunity to be heard. Moreover, the issue is not an appropriate one for this Court's review. There is no circuit conflict, and the issue is unlikely to recur. The events that required the Commission to name unknown persons as defendants and thereafter to publish notice of its complaint in an international newspaper were highly unusual, and the likelihood of their ever recurring should be significantly reduced by recently negotiated memoranda of understanding with certain foreign governments concerning access to securities-related information. Finally, even if the issue otherwise deserved further review, the present case is an inappropriate vehicle for doing so. There is compelling evidence, which petitioners have not contested, that Leati and Lombardfin received an actual copy of the Summons with Notice shortly after its publication, and thus, in any event, petitioners are not ultimately entitled to prevail on the merits of their constitutional challenge to the service of process.

a. Petitioners contend (87-1321 Pet. 13-21)--in a claim never raised below--that the district court lacked the statutory authority to order service by publication in this case. That contention is mistaken. In ordering the Commission to serve petitioners with a Summons with Notice

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it disposed of the jurisdictional issue on other grounds, the court of appeals denied the Commission's motion (Pet. App. A18 n.6).

by publication in the *International Herald Tribune*, the district court acted pursuant to Fed. R. Civ. P. 4 (Pet. App. A73), which authorizes that method of service in the present circumstances. Rule 4(e) provides, in pertinent part, that "[w]henever a statute of the United States or an order of court thereunder provides for service of a summons, or of a notice * * * upon a party not an inhabitant of or found within the state in which the district court is held, service may be made under the circumstances and in the manner prescribed by the statute or order * * *." Section 27 of the Exchange Act, 15 U.S.C. 78aa, permits worldwide service of process, and thus it constitutes, for purposes of Rule 4(e), a statute of the United States that provides for service upon a party outside the state. Cf. *Omni Capital Int'l, Ltd.* v. *Rudolf Wolff & Co.*, No. 86-740 (Dec. 8, 1987), slip op. 10. Section 27 does not, however, specify or in any way limit the manner of service. See *International Controls Corp.* v. *Vesco*, 593 F.2d 166, 175 (2d Cir.), cert. denied, 442 U.S. 941 (1979). Thus, pursuant to Rule 4(e), the district court was authorized to permit service to be effected "in the manner prescribed by * * * order."[6]

Petitioners contend (87-1321 Pet. 14-15, 18) that Section 27 implicitly forbids service by publication, and alternatively that since Section 27 does not expressly provide for service by publication, Rule 4(e) does not apply. No court has so held, and neither contention is correct. First, petitioners misread Section 27. By its terms, that provision

[6] Service by publication could also have been made under Fed. R. Civ. P. 4(i)(1)(E). That rule provides, in pertinent part, that when a federal law (like Section 27) authorizes service on a party overseas, the service of a summons and complaint may be effected "as directed by order of the court." Although, as petitioners point out (87-1321 Pet. 16), the publication in the newspaper did not include the complaint, the Summons with Notice incorporated all of the essential elements of the complaint (see Pet. App. 108a-109a).

simply states that in actions to enforce any liability under the Exchange Act, process may be served "wherever the defendant may be found" (15 U.S.C. 78aa). Section 27 does no more than authorize world-wide service of process; it does not dictate how that process may be effected, and certainly does not *forbid* service by publication. Second, Rule 4(e) does not require that the relevant federal statute expressly specify the means of service. To the contrary, we think the best reading of the rule is the one the district court reached: that where the statute authorizes service, but does not "prescrib[e] * * * the manner of service," the court may do so by its own order thereunder.[7]

b. Petitioners challenge (87-1321 Pet. 8-13) the constitutionality of service by publication in this case, claiming (*id.* at 8) that "notice by publication to unidentified persons whose names and addresses are known is constitutionally impermissible to establish *in personam* jurisdic-

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[7] Petitioners' reliance (87-1321 Pet. 18-21) on the Hague Convention on Service Abroad of Judicial and Extra-Judicial Documents in Civil or Commercial Matters, *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638, 658 U.N.T.S. 163, is misplaced. First, petitioners did not raise that issue in the court of appeals and may not do so for the first time in this Court. See *United States* v. *Lovasco*, 431 U.S. 783, 788 n.7 (1977). In any event, Article 1 of the Convention, 20 U.S.T. 362, expressly states that "[this] Convention shall not apply where the address of the person to be served with the document is not known"—precisely the situation here (see Pet. App. A13-A15). Moreover, the Convention does not expressly prescribe mandatory means for a government agency, such as the Commission, to serve process. See U.S. Amicus Br. at 12 n.11, *Volkswagenwerk Aktiengesellschaft* v. *Schlunk*, cert. granted, No. 86-1052 (Oct. 13, 1987), copies of which have been served on the parties in the present case. Whether the Convention should nonetheless be construed to require its use by government agencies is a novel question that should not be decided in the absence of rulings by lower federal courts.

tion." But petitioners beg the question. The district court (Pet. App. A73), affirmed by the court of appeals (*id.* at A13-A17), found that the Commission did *not* know of petitioners' part in the illegal transactions until late in 1985, when for the first time petitioners' role in the fraud was disclosed. As the court of appeals noted (*id.* at A19), the Commission could not have identified petitioners among the unknown purchasers because "Leati's affidavit and misleading trading records deceived the Commission into believing that they were not involved in Tome's scheme."

For that very reason, petitioners' reliance (87-1321 Pet. 11-12) on this Court's decisions in *Mennonite Bd. of Missions* v. *Adams*, 462 U.S. 791 (1983), and *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), is misplaced. In each of those cases, the Court rejected publication as a means of notice because personal service or mailed notice was a readily available alternative. See *Mennonite Bd.*, 462 U.S. at 798 (personal or mailed notice is required where "the mortgagee is identified in a mortgage that is publicly recorded"); *Mullane*, 339 U.S. at 318 ("Where the names and post-office addresses of those affected by a proceeding are at hand, the reasons disappear for resort to means less likely than the mails to apprise them of its pendency.").[8] Where, on the other hand, the names and addresses of the affected parties "are either

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[8] See also *Schroeder* v. *City of New York*, 371 U.S. 208 (1962) (publication in a newspaper and posted notices were inadequate to apprise a property owner of condemnation proceedings when his name and address were readily ascertainable from both deed records and tax rolls); *Walker* v. *City of Hutchinson*, 352 U.S. 112 (1956) (notice of condemnation proceeding published in a local newspaper was an inadequate means of informing a landowner whose name was known to the city and was on official records). As the Court put the matter in *Schroeder*, "[t]he general rule that emerges from the *Mullane* case is

conjectural" or "do not in due course of business come to knowledge" (*Mullane*, 339 U.S. at 317), the Court has not found service by publication to be insufficient. Indeed, the Court explained in *Mullane* that it "has not hesitated to approve of resort to publication as a customary substitute * * * where it is not reasonably possible or practicable to give more adequate warning. Thus it has been recognized that, in the case of persons missing or unknown, employment of an indirect and even a probably futile means of notification is all that the situation permits and creates no constitutional bar to a final decree foreclosing their rights." *Ibid.*[9]

In the present case, publication in the *International Herald Tribune* was hardly a "futile means of notification." To the contrary, as the court of appeals explained (Pet. App. A17), "[t]he SEC reasonably concluded that the purchasers resided or conducted business in Europe and chose a publication likely to be read by international investors." Moreover, the court observed (*ibid.*), "[t]he propriety of this method of notice must also be considered in light of the fact that members of the securities industry like Leati and Lombardfin may be expected to be

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that notice by publication is not enough with respect to a person whose name and address are known or very easily ascertainable" (371 U.S. at 212-213).

[9] The Fifth Circuit's decision in *Nagle* v. *Lee*, 807 F.2d 435 (1987), is not to the contrary. The court of appeals held in that case that "the mere naming of a person through use of a fictitious name does not make that person a party absent voluntary appearance or proper service of process" (*id.* at 440). The court recognized, however, that a party may be summoned with fictitious names where " 'the summons and complaint or other notice of the proceedings [furnishes] a reasonable apprisal that the action concerns him.' " *Ibid.* (quoting Restatement (Second) of Judgments § 34 comment d (1982)).

aware of a publicly announced SEC investigation involving insider trading during a high-visibility takeover." And as the district court (*id.* at A73), affirmed by the court of appeals (*id.* at A17-A20), found, petitioners Leati and Lombardfin did indeed learn of the pendency of the lawsuit, well in advance of the date of trial. But although they were given the opportunity to be heard, petitioners "made a conscious decision to ignore this action until after a judgment had been rendered against them" (*id.* at A20).[10] On the record before the district court, there is no question that petitioners received constitutionally sufficient notice of this action. See *National Equipment Rental, Ltd.* v. *Szukhent*, 375 U.S. 311, 315 (1964).

c. Petitioners' challenge to the service of process in this case does not warrant further review for the additional reason that it is unlikely that the Commission will in the future be obliged to resort to similar means of serving process. The Commission has on only one other occasion, also in 1981, commenced an action and sought to publish notice under circumstances like those in this case. See *SEC* v. *Certain Unknown Purchasers*, No. 81 Civ. 6553 (S.D.N.Y. Feb. 26, 1986), aff'd on other grounds, 817 F.2d 1018 (2d Cir. 1987), cert. denied, No. 87-769 (Feb. 22, 1988). Moreover, the Commission has recently negotiated memoranda of understanding with the Swiss gov-

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[10] Indeed, it was petitioners' persistent evasions and misrepresentations that prevented the Commission from discovering at an earlier date that petitioners were involved in the fraud. As the court of appeals noted (Pet. App. A12-A13), Leati and Lombardfin took a series of steps to conceal their participation in the St. Joe purchases by submitting a misleading affidavit and falsified records of trades to the Commission. Having gone to such lengths to cover up their illegal activities, petitioners may not call upon this Court to set aside the concurrent findings of the courts below that publication notice was sufficient.

ernment and other foreign governments that will give the agency greater access to information during investigations of alleged securities violations.[11] As a result, the Commission will more readily be able to identify the beneficial owners of accounts in foreign financial institutions and will be significantly less likely to require publication notice as a means of securing personal jurisdiction.

d. Finally, even if the legal issue presented otherwise deserved further review, this case is not an appropriate vehicle for doing so, since, in any event, petitioners are not ultimately entitled to prevail on the merits of their constitutional challenge. The Commission moved in the court of appeals to supplement the record or, in the alternative, for a remand to the district court, so that it could present evidence showing that in 1982, shortly after the publication, a copy of the Summons with Notice had been retrieved from the Lombardfin files by one of Leati's former business partners. See C.A. SEC Supp. App. 16-22.[12]

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[11] See Memorandum of Understanding Between the United States and Switzerland to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading, 22 I.L.M. 1 (1982); Memorandum of Understanding Between the United States Securities and Exchange Commission and the Ontario Securities Commission, the Commission des Valeurs Mobiliers du Quebec, and the British Columbia Securities Commission (Jan. 7, 1988); Memorandum of Understanding on Exchange of Information Between the United States Securities and Exchange Commission and the United Kingdom Department of Trade and Industry in Matters Relating to Securities and Between the United States Commodity Futures Trading Commission and the United Kingdom Department of Trade and Industry in Matters Relating to Futures (Sept. 23, 1986); Memorandum of Understanding Between the United States Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information (May 23, 1986).

[12] The Commission was obliged to make that motion because petitioners elected to challenge the district court's exercise of personal

Petitioners did not dispute the evidence proffered by the Commission. The court of appeals nonetheless found it unnecessary to consider this material in order to resolve the jurisdictional issue in the case, and it therefore denied the Commission's motion to supplement or remand. See Pet. App. A18 n.6. If, however, the constitutional issue is not disposed of on the ground that the court of appeals reached, it would be necessary to reach the question of actual receipt of the published notice, and the Commission would be entitled to prevail on the basis of the proffer that it made in the court of appeals.

2. Petitioners ask (87-1321 Pet. 22-24; 87-1368 Pet. 5-9) the Court to decide the question whether trading in securities of a target company while in possession of material nonpublic information misappropriated from a tender offeror (here, Seagram) is beyond the scope of Section 10(b) of the Exchange Act and Rule 10b-5.[13] They

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jurisdiction directly in the court of appeals, rather than move to reopen the district court proceedings by a post-trial motion under Fed. R. Civ. P. 60(b). For that reason, the Commission was unable to complete the record in the district court on the jurisdictional challenge.

[13] We believe that this Court should decline, in any event, to consider the petition in No. 87-1368. As the court of appeals observed (Pet. App. A21), the petitioning Panamanian corporations are merely alter egos of Tome, who remains a fugitive from justice on related criminal securities fraud charges (*id.* at A4, A66). This Court has held that a fugitive may not invoke the jurisdiction of an appellate court to review his conviction, because evading the law "disentitles the defendant to call upon the resources of the [c]ourt * * *." *Molinaro* v. *New Jersey*, 396 U.S. 365, 366 (1970). See also *United States* v. *Sharpe*, 470 U.S. 675, 681 n.2 (1985). The courts of appeals have extended this principle to fugitives' appeals taken in related civil cases. See, *e.g.*, *United States* v. *$45,940 in United States Currency*, 739 F.2d 792, 797 (2d Cir. 1984); *Conforte* v. *Commissioner*, 692 F.2d 587 (9th Cir. 1982), stay denied, 459 U.S. 1309 (1983) (Rehnquist, Circuit Justice) (noting this Court's practice of denying petitions for certiorari where

contend (87-1321 Pet. 22-23; 87-1368 Pet. 5-6, 7-9) that this Court's decision in *Carpenter* v. *United States*, No. 86-422 (Nov. 16, 1987), expressly left that question open and that this case is an appropriate vehicle for resolving the issue. That contention is mistaken for three reasons.[14]

First, petitioners did not challenge the misappropriation theory in the court of appeals, and thus they did not give that court an opportunity to reexamine its prior decisions upholding liability in cases such as this. Accordingly, the claim is not properly presented for review by this Court. See *United States* v. *Lovasco*, 431 U.S. 783, 788, n.7 (1977); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970).

Second, petitioners are not correct in suggesting that the present case involves the same issue on which the Court was equally divided in *Carpenter*. The question in *Carpenter*, as the Court put it (slip op. 5), was whether Rule 10b-5 was violated when a " 'newspaper is the only alleged victim of fraud and has no interest in the securities traded.' " The Court noted that in *Carpenter* the newspaper, which was "the victim of the fraud," was not a

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courts of appeals have applied *Molinaro* to a civil case). The court of appeals in the present case refused, without explanation, to apply that principle to the Panamanian corporations in this case (see Pet. App. A4 n.1). In our view, however, Tome should not be permitted to invoke the jurisdiction of this Court indirectly through his petitioning alter ego corporations at the same time that he is flouting the processes of law in a related criminal proceeding.

[14] In passing, petitioner Leati also suggests (87-1321 Pet. 23 n.21) that Tome never told him about the forthcoming tender offer by Seagram, and professes (87-1321 Pet. 24 n.23) that he had no idea that Tome had breached a duty of trust or confidence to Seagram or Bronfman. The district court found otherwise, however (see Pet. App. A55-A58, A73), and the court of appeals upheld those findings (*id.* at A9). Petitioner does not contend that the district court's findings are clearly erroneous.

"buyer or seller of the stocks traded in or otherwise a market participant" (*id.* at 4). By contrast, Seagram, the company from which petitioners misappropriated information concerning the impending tender offer, was decidedly "a market participant" and had a significant "interest in the securities traded." The law governing petitioners' misconduct is thus hardly "uncertain" (87-1368 Pet. 8); indeed, this Court has twice declined review in cases that upheld liability under Rule 10b-5 for trading while in possession of material nonpublic information misappropriated (directly or indirectly) from a tender offeror. See *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir.), cert. denied, 464 U.S. 863 (1983); *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985). No court has held to the contrary.

Third, petitioners' conduct clearly falls within the proscriptions of the federal securities laws. Section 10(b) prohibits the use, "in connection with the purchase or sale of any security," of "any manipulative or deceptive device or contrivance" in violation of rules promulgated by the Commission. Rule 10b-5 in turn prohibits "any person" from engaging in "any act [or] practice" that "operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of securities. This Court has consistently construed these provisions broadly, noting that Section 10(b) is "a 'catchall' clause to enable the Commission 'to deal with new manipulative or cunning devices.' " *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976) (brackets omitted). The Court has emphasized that the statute and rule "are obviously meant to be inclusive." *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972). See generally *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 386 (1983); *United States* v. *Naftalin*, 441 U.S. 768, 773 (1979). See also S. Rep. 792, 73d Cong., 2d

Sess. 6 (1934). And, since trading while in possession of information stolen from a tender offeror concerning an impending tender offer plainly "touches" both the offeror's purchase of securities in the tender offer and the wrongdoer's own trading (*Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971)), there is no doubt that the "in connection with" requirement of Section 10(b) and Rule 10b-5 is satisfied. Petitioners offer no reason whatever why the broad proscriptions of the securities laws do not cover their misconduct.[15]

3. Petitioners claim (87-1321 Pet. 24-27; 87-1368 Pet. 9-16) that the district court lacked the authority to require them to disgorge their illegal profits. That contention does not warrant further review. Every court that has considered this issue has agreed that, in an enforcement action brought by the Commission, federal courts possess the equitable power to require defendants to disgorge wrongfully obtained profits. See, *e.g.*, *SEC* v. *Wencke*, 783 F.2d 829, 837 n.9 (9th Cir. 1986), cert. denied, No. 85-1896 (Oct. 6, 1986); *SEC* v. *Blavin*, 760 F.2d 706 (6th Cir. 1985); *SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC* v. *Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 102 (2d Cir. 1978); *SEC* v. *Texas Gulf*

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[15] In the report accompanying the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, the House explained that "[i]n other areas of the law, deceitful misappropriation of confidential information by a fiduciary * * * has consistently been held to be unlawful"; it added that Congress "has not sanctioned a less rigorous code of conduct under the federal securities laws." H.R. Rep. 98-355, 98th Cong., 1st Sess. 5 (1983) (footnotes omitted). Indeed, this Court has twice suggested that trading on " 'misappropriate[d] or illegally obtain[ed] information' "—the activity in which petitioners engaged—may constitute fraud in violation of Rule 10b-5. *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 313 n.22 (1985) (citation omitted); *Dirks* v *SEC*, 463 U.S. 646, 665 (1983).

Sulphur Co., 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971).[16]

Petitioners assert (87-1321 Pet. 27; 87-1368 Pet. 11, 13-15), however, that disgorgement is not available in this case, because it is only intended to make restitution to private investors and no such private investors have a valid action for restitution on the facts of this case.[17] Petitioners misapprehend the purpose of the disgorgement remedy. The primary purpose of disgorgement is to deprive the wrongdoer of his ill-gotten gain (*SEC* v. *Blatt*, 583 F.2d at 1335). Thus, as the Sixth Circuit explained in the *Blavin* case, "[o]nce the Commission has established that a defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without

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[16] The Ninth Circuit's decision in *United States* v. *Parkinson*, 240 F.2d 918 (1956), is not to the contrary. That case involved an action by the Food and Drug Administration to enjoin the defendants from introducing certain misbranded drugs into interstate commerce. In an alternative holding (see *id.* at 919), the court of appeals ruled that the district court lacked jurisdiction under the applicable statutes to order the defendants to make restitution to purchasers of their product. The *Parkinson*, case, however, does not address the authority of a district court to order disgorgement in an SEC enforcement action. On that issue, the Ninth Circuit's more recent decision in *SEC* v. *Wencke*, 783 F.2d at 837 n.9, states plainly that "courts may require disgorgement of diverted assests in securities fraud actions."

[17] The Commission rejects petitioners' premise that persons who traded with the defendants lack a cause of action for damages under the securities laws. In the Commission's view, such persons are defrauded investors who may bring actions under Sections 10(b) and 14(e) of the Exchange Act and SEC Rules 10b-5 and 14e-3. To the extent that *Moss* v. *Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983), cert. denied, 465 U.S. 1025 (1984), holds to the contrary with respect to Section 10(b) and Rule 10b-5, the Commission believes that case to be wrongly decided. The tender offeror, from which the information was stolen, may also have a claim for damages under the federal securities laws.

inquiring whether, or to what extent, identifiable private parties have been damaged by [the] fraud" (760 F.2d at 713).[18]

Finally, this Court's decision in *Tull* v. *United States*, No. 85-1259 (Apr. 28, 1987), does not require a different result. In the *Tull* case, the Court held that the Seventh Amendment guarantees a jury trial to determine liability in actions by the government seeking civil penalties under the Clean Water Act, 33 U.S.C. 1251 *et seq.* There is no indication that the Court's "passing reference" (Pet. App. A24 n.7) in the decision to disgorgement—noting (*Tull*, slip op. 11) that it "is a remedy only for restitution"—was intended to alter the well-established principle that disgorgement is an equitable remedy that is routinely available in an SEC enforcement action.[19]

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[18] Moreover, even if the disgorged funds were to revert to the United States Treasury, there would be nothing "punitive" (87-1368 Pet. 12) about the disgorgement order, since the disgorgement in this case was limited to the amount of petitioners' unjust enrichment—their illegal profits plus interest.

[19] Leati's and Lombardfin's reliance on what the federal securities laws do *not* say (87-1321 Pet. 25) is misplaced, since they can point to no express statutory prohibition of disgorgement. Cf. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 391 (1970) (the Court "cannot fairly infer from the Securities Exchange Act of 1934 a purpose to circumscribe the courts' power to grant appropriate remedies"). Indeed, Congress endorsed the well-established remedy of disgorgement in enacting the new civil penalties under the Insider Trading Sanctions Act in 1984. There, the House Report made it plain that civil penalties were to be in addition to the disgorgement of illegal profits. See H.R. Rep. 98-355, 98th Cong., 1st Sess. 8 (1983). Petitioners' further contention (87-1321 Pet. 26-27)—that the authority of the federal courts to enforce the securities laws should be narrowly construed—ignores the long-standing principle that the securities statutes must be interpreted in a manner to accomplish their congressional purpose " 'to make [securities] regulation and control reasonably complete and effective' " (*Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 386 (1983) (quoting 15 U.S.C. 78b)), and to deter future wrongdoing (*Randall* v. *Loftsgaarden*, No. 85-519 (July 2, 1986), slip op. 15-16).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

LOMBARDFIN S.p.A. and PAOLO MARIO LEATI,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONERS LOMBARDFIN S.p.A. AND PAOLO MARIO LEATI

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I

PETITIONERS WERE NEVER SERVED WITH PROCESS AND THE JUDGMENT TAKEN AGAINST THEM IS A DENIAL OF DUE PROCESS

Petitioners were never served with any summons or complaint, and the only notice they ever received that the SEC intended to include them as defendants was seven days before trial, when they received a copy of a motion requesting leave to amend the

complaint to name them as defendants. Thereafter, no summons or complaint was ever served on them. Instead, the court granted the SEC's motion to amend and immediately thereafter, without any further notification to petitioners, commenced the trial, which lasted less than a day.[1]

Petitioners were denied their constitutional rights of due process, and the judgment, taking more than $2,000,000 from them as well as subjecting them to serious administrative sanctions, must be vacated. If this ruling is allowed to stand, it will provide precedent for other plaintiffs, both governmental and private, to avoid the long-standing constitutional requirement of personal service in *in personam* actions where the plaintiff has the defendant's name and address.

A. Assertion Of Jurisdiction Was Improper Where Defendants Were Not Apprised Of Their Status As Defendants

The SEC and the courts below purport to justify this deprivation of property without due process by claiming that the *International Herald Tribune* publication gave the petitioners notice of the pendency of the action and they chose not to appear. (Pet. App. A20, A73; SEC Br. at 8)[2]. This claim, however, confuses notice of pendency of an action with the requirement to apprise an individual that he is called upon to defend himself in the action. Leati and Lombardfin did have notice that the action existed. They did not, however, have any knowledge that they were intended defendants and, thus, had no notice of any obligation to defend.

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[1] Obviously, as a pleading amendment, the pleading was required to be served on petitioners and the new defendants given time to appear and respond. *See* Fed. R. Civ. P. 5 and 15. There was no court order to the contrary.

[2] References to "Pet. App." are to the Petitioners' Appendix; references to "Pet." are to Petitioners' Petition For A Writ Of Certiorari; references to "SEC Br." are to the SEC's Brief in Opposition To A Writ Of Certiorari; references to "App. Br." are to Petitioners' Appellants' Brief in the Second Circuit Court of Appeals; references to "SEC App. Br." are to the SEC's Brief as Appellee in the Second Circuit Court of Appeals.

Even if they had seen the publication in the *International Herald Tribune*, as the SEC now contends by reference to matter outside the record below,[3] that publication did not give them notice that they were defendants. (*See* Pet. App. A106-A107). On the contrary, since the SEC knew their names and addresses and knew of their involvement in the subject trades, and indeed, at that very time was in communication with petitioners' counsel on this matter, Leati and Lombardfin were entitled to conclude that the SEC would have named them personally if they were intended to be defendants in that action. Even in the absence of their communication with the SEC, Leati and Lombardfin were entitled to rely on the theretofore untarnished certainty of the constitutionally mandated service of a summons, personally or by mail, to give them notice that they were defendants and their property was at risk.

Moreover, even actual notice of one's status as a defendant is irrelevant to the jurisdiction issue if the individual sought to be brought within the court's power is not properly served. *E.g.*, *Sieg* v. *Karnes*, 693 F.2d 803, 807 (8th Cir. 1982). There is no obligation on the part of a person who has not been properly served with process to answer the complaint or otherwise to appear in an action. *Wuchter* v. *Pizzutti*, 276 U.S. 13, 24 (1928).

B. The Trial Court's Order Directing Service Of A Summons By Publication Did Not Create *In Personam* Jurisdiction

The SEC does not dispute the clear holding of *Mennonite Board of Missions* v. *Adams*, 462 U.S. 791 (1983), that service by publication is impermissible when the name and address of the defendant are reasonably ascertainable. It concedes that it knew their names and addresses. (SEC App. Br. at 50). Further, it knew of Lombardfin's involvement in the purchases of St. Joe

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[3] The SEC referred to affidavit statements purporting to evidence that Leati and Lombardfin received a copy of the newspaper publication (SEC Br. at 8-9 n.5, 15-16), which it had sought to introduce below in a motion to supplement the record. The motion was denied by the Court of Appeals. (Pet. App. A18 n.6).

securities (*see* Pet. at 4, 12 n.8), including Tome's telephone contact with Lombardfin, at the time it sought the trial court's order permitting service by publication.[4] The SEC contends only that it did not know that Leati and Lombardfin were "culpable" (SEC Br. at 5), having been allegedly misled by Leati's statement in his affidavit that he and Lombardfin were innocent of trading on the basis of nonpublic information. They still maintain their innocence and maintain that the finding of liability below is unsupported by the evidence and is clearly erroneous.[5] *Mennonite* makes no exception to its "*per se* rule against constructive notice," 462 U.S. at 805 (dissenting opinion), for a situation where the plaintiff has not yet decided to sue a person whose name, address and involvement are known to the plaintiff.

Even when the SEC changed its mind and decided to sue Leati and Lombardfin in the Fall of 1985 (SEC Br. at 5; SEC App. Br. at 14), it chose not to attempt to serve them with a summons and complaint naming them as defendants. Instead, the SEC chose to wait until the eve of trial and, through the guise of a motion to amend the caption of the complaint, proceeded as if petitioners had been defendants all along, relying on the publication to unnamed purchasers three and one-half years earlier placed in the *International Herald Tribune*.

Not only was the publication order unconstitutional, but it was improper under Rule 4 of the Federal Rules of Civil Procedure. The SEC has admitted that the publication did not include a complaint (SEC Br. at 10 n.6) and, thus, that Judge

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[4] The publication itself refers to Lombardfin as one of the brokers through which the intended defendants had purchased the securities. (Pet. App. A106-A107).

[5] The SEC is mistaken when it says that petitioners do not claim the finding of liability was clearly erroneous. (SEC Br. at 17 n.14). Petitioners so argued to the Second Circuit. (App. Br. at 21 n.16). While the SEC further contends that the Court of Appeals' ruling should not be disturbed because liability was conclusively established, due process requires more than an *ex parte* proceeding at which out-of-court statements taken without cross-examination are offered as proof of liability.

Pollack's order authorizing service by publication of a summons without a complaint failed to meet the requirements of Fed. R. Civ. P. 4(i)(1)(E).[6] The SEC mistakenly seeks to characterize the order of publication as one authorized by Fed. R. Civ. P. 4(e).[7] That rule, however, is limited in its applicability to orders of service which are expressly authorized by statute.[8] Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1982), is not such a statute. It does not expressly authorize the issuance of any order regarding service. Thus, the order of publication

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[6] The SEC apparently claims that the requirement of service of a complaint was effectively satisfied, notwithstanding the admitted absence of a complaint because, it maintains, the publication notice sufficiently described the allegations of the complaint. (SEC Br. at 10 n.6). Even if the complaint requirement of Rule 4(i) could ever be satisfied in such a manner, the publication notice in this case can in no way be considered the equivalent of a complaint. It contains no allegations of any activity in violation of any law. All it says about the nature of the case is that the action is one "alleging violations of [securities law provisions] . . . , which provisions, *inter alia*, prohibit the use of material, non-public information in connection with securities transactions." (Pet. App. A107) (citations omitted).

[7] Rule 4(e) provides that "[w]henever a statute of the United States or an order of court thereunder provides for [extraterritorial service] . . . service may be made under the circumstances and in the manner prescribed by the statute or order, or, if there is no provision therein prescribing the manner of service, in a manner stated in this rule. . . . " Fed. R. Civ. P. 4(e).

[8] *See* Advisory Committee's Note to Proposed Amendment to Rules of Civil Procedure, Rule 4, Subdivision (e) (1963), *reprinted at* 31 F.R.D. 628 (1963). As has long been recognized,

> "[t]he words 'order of court' must be understood as limited to orders authorized by a specific federal statute. . . . The court is not given blanket authority to enter its rule or order for substituted service or for personal service beyond the state. And the rule does not sanction departure from standards of notice and publication prescribed by statute . . . ."

1 Barron & Holtzoff, Federal Practice and Procedure 731-32 (Wright ed. 1960) (footnotes omitted). Thus, Rule 4(e) does not provide independent authorization for service; it merely continues the effectiveness of certain federal statutes which might otherwise be superseded by Rule 4, "rather in the nature of a saving clause or exception." *Id.* at 729.

was not an order within the meaning of Rule 4(e) and was, accordingly, not authorized under that rule. Nor was the publication order authorized under any other provision of Rule 4 or by statute. (*See* Pet. at 13-18).

C. This Ruling, If Not Vacated, Will Be Precedent For Further Avoidance Of The Constitutional Requirements Of Effective Service Of Process

One of the mandates of due process as it relates to civil litigation is that the defendant be given the most effective notice reasonably possible that he has been named a defendant in order that he has the opportunity to defend, including the right to confront and cross-examine witnesses and to interpose affirmative defenses. There can be no constitutional taking of property absent such notice. The ruling below makes a sham of those constitutional protections. While the SEC argues that this case does not warrant certiorari because there is no conflict in the circuits, it must be recognized that, given the clear rulings by this Court in *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), and *Mennonite, supra*, it is not surprising that no other court has chosen to disregard this mandate. The SEC argues that this case is unique and is not likely to be repeated by it because of the signing of various bilateral memoranda. (SEC Br. at 9, 14-15). While petitioners do not agree with this point, it must be recognized that these petitioners have been denied their constitutional rights, reason enough to grant certiorari, and that this case, if not vacated, will be precedent for other litigants, both public and private, to find ways to convince a court that they also should be excepted from the requirements of *Mullane* and *Mennonite*.[9]

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[9] The Second Circuit stated that the publication was reasonable because petitioners were "members of the securities industry" and could be "expected to be aware of a publicly announced SEC investigation." (Pet. App. A17). However, as this Court stated in *Mennonite Board of Missions, supra*, "[p]ersonal service or mailed notice is required even though sophisticated creditors have means at their disposal to discover whether property taxes have not been paid and whether tax-sale proceedings are therefore likely to be initiated." 462 U.S. at 799.

II

THE ARGUMENTS CONCERNING THE HAGUE SERVICE CONVENTION, THE "MISAPPROPRIATION" THEORY AND LACK OF AUTHORIZATION BY STATUTE OR RULE FOR SERVICE BY PUBLICATION ARE PROPERLY BEFORE THIS COURT

The SEC contends that petitioners improperly refer to the Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters (the "Hague Service Convention"), *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638 (SEC Br. at 11 n.7) and to the "misappropriation" theory of liability under SEC Rule 10b-5 (SEC Br. at 17), arguing that they were not presented to the Court of Appeals. Further, the SEC contends in passing that petitioners' arguments concerning lack of authorization by statute or rule for service by publication were not raised below. (SEC Br. at 9). All these arguments constitute enlargements of arguments made in the Second Circuit and may properly be considered by this Court. *Dewey* v. *Des Moines*, 173 U.S. 193, 197-98 (1899); *Raley* v. *Ohio*, 360 U.S. 423, 437 n.12 (1959).[10]

Consideration of whether the Hague Service Convention should have been used to effect service of process is fairly comprised within petitioners' due process challenge to the district court's order permitting service by publication. (App. Br. 12-17). This Court is entitled to consider that a ratified treaty, to which the United States and Italy were parties, was in effect setting forth the appropriate method for international service of process. Reference to the Hague Service Convention bolsters the assertions made below that the SEC could have served Leati and Lombardfin personally had they ever attempted to do so. Accordingly,

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[10] The fact that these issues were not mentioned below by "book and verse" does not preclude their review by this Court. *Eddings* v. *Oklahoma*, 455 U.S. 104, 113-14 n.9 (1982).

consideration of petitioners' argument concerning the Hague Service Convention adds greater specificity to the due process defect raised and dealt with in the Court of Appeals, and it is properly before this Court.[11] *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 159 n.5 (1980). Similarly, the argument concerning the lack of authorization by statute or rule for service by publication in this case also adds greater specificity to the due process defect raised below.

The reference in the Petition For A Writ Of Certiorari to the "misappropriation" theory is an enhancement of the argument made below that mere possession of information does not give rise to a duty to refrain from trading. (App. Br. at 19-31). Petitioners argued to the Second Circuit that there was no *scienter* proved against them because they were unaware that Giuseppe Tome was conveying material nonpublic information obtained improperly by him as a result of his relationship to Joseph E. Seagram & Sons, Inc., the classic application of the "misappropriation" theory.

The fact that the "misappropriation" theory was not squarely attacked in the context of petitioners' argument on the lack of *scienter* is understandable in light of both the fact that Tome himself, the alleged "misappropriator", was not even before the Court of Appeals, his appeal previously having been dismissed, and the fact that the Second Circuit had consistently approved the "misappropriation" theory. However, particularly if the court grants certiorari on the service of process issue, it would seem proper in light of *Carpenter* v. *United States*, 108 S. Ct. 316 (1987), that the "misappropriation" theory be presented as well since without it there could not have been any *scienter*.

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[11] While the grant of certiorari in *Volkswagenwerk Aktiengesellschaft* v. *Schlunk*, *cert. granted*, No. 86-1052 (Oct. 13, 1987) (argued Mar. 21, 1988), confirms the importance of the issue of the exclusivity of the Hague Service Convention, that case does not raise the issue presented here of whether, given the Hague Service Convention, the SEC was free to seek an order directing publication abroad.

CONCLUSION

For the reasons set forth in this reply as well as those set forth in the Petition For A Writ Of Certiorari, this Court should grant certiorari to review the constitutionally defective judgment entered against petitioners Leati and Lombardfin.

Respectfully submitted,

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